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Second Session—Twenty-eighth Parliament

1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

The Honourable DOUGLAS D. EVERETT, *Acting Chairman*

No. 24 - 29

THURSDAY, MAY 14th, 1970

Eighteenth Proceedings on the Government White Paper, entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 24:5)

APPENDICES:

"A"—Brief from Trizec Corporation Ltd.
"B"—Analysis of Appendix "A" by Senior Advisor.
"C"—Brief from the Nova Scotia Fruit Growers' Association.
"D"—Brief from The Canadian Medical Association.

22009—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *chairman*

The Honourable Senators:

Aird	Croll	Isnor
Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Macnaughton
Blois	Giguère	Molson
Burchill	Grosart	Phillips (*Rigaud*)
Carter	Haig	Walker
Choquette	Hayden	Welch
Connolly (*Ottawa West*)	Hays	White
Cook	Hollett	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

22009—1½

MINUTES OF PROCEEDINGS

THURSDAY, May 14th, 1970.
(35)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aird, Aseltine, Beaubien, Benidickson, Blois, Carter, Connolly (*Ottawa West*), Flynn, Everett, Giguere, Haig, Hays, Isnor, Kinley, Molson, Phillips (*Rigaud*), and Welch —(18).

Present, but not of the Committee: The Honourable Senators Laird, Smith, Sullivan and Urquhart—(4).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

Trizec Corporation Limited:

Mr. W. Hay, Executive Vice-President;
Mr. N. F. Phillips, Q.C., Counsel.

Nova Scotia Fruit Growers' Association:

Mr. E. W. Peill, Chairman, Committee on Tax Reform Proposals;

Mr. P. Gervason, Economist, Extension & Economics Branch, Department of Agriculture, Nova Scotia.

At 11:15 a.m. the Committee adjourned.

AFTERNOON SITTING

2:00 p.m.
(36)

At 2:00 p.m. the Committee *resumed.*

Present: The Honourable Senators Aird, Aseltine, Beaubien, Benidickson, Blois, Carter, Connolly (*Ottawa West*), Everett, Haig, Isnor, Kinley, Molson, Phillips (*Rigaud*) and Welch—(15).

Upon motion the Honourable Senator Everett was elected *Acting Chairman.*

Present, but not of the Committee: The Honourable Senators Smith and Sullivan—(2).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

Canadian Medical Association:

Dr. R. M. Matthews, President;
Dr. C. L. Gosse, Member;
Dr. J. Sylvestre, Member;
Dr. L. R. Harnick, Member of the Finance Committee;
Mr. B. E. Freamo, Acting General Secretary;
Dr. R. Salter, The Royal College of Physicians and Surgeons of Canada;
Dr. R. Dixon, President, The Royal College of Physicians and Surgeons of Canada.

Ordered:—That the documents submitted at the meeting today be printed as appendices to these proceedings as follows:

A—Brief from Trizec Corporation Ltd.
B—Analysis of Appendix "A" by Senior Advisor.
C—Brief from the Nova Scotia Fruit Growers' Association.
D—Brief from The Canadian Medical Association.

At 4:15 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Thursday, May 14, 1970.

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have two briefs before us this morning. I should at this stage tell you that we have an added starter this afternoon around 2 o'clock. While we asked them to be here for 2. I say around 2 o'clock so that you will have time to get your attendance in the chamber. Our added starter is the Canadian Medical Association. They were originally listed to be before us in about two weeks' time, but they are in Ottawa this morning because they were appearing before the Finance Committee of the House of Commons and so they asked to be heard by us this afternoon, and we have arranged accordingly.

Our first brief this morning is from the Trizec Corporation Limited. As witnesses we have Mr. W. Hay, Executive Vice-President, and Mr. N. F. Phillips, Q.C., Counsel.

Honourable senators, at this point I should mention that the simultaneous translation system may be rather noisy and I should ask you whether you feel that we need it this morning?

Senator Beaubien: I move that we suspend it.

The Chairman: Is that agreed, honourable senators?

Hon. Senators: Agreed.

The Chairman: Mr. Hay, do you wish to make an opening statement.

Mr. W. Hay, Executive Vice-President, Trizec Corporation Limited: Mr. Chairman and honourable senators, I would like to thank you for giving us the opportunity to present this brief on behalf of Trizec Corporation Limited. Trizec is a company which is primarily engaged in real estate investment and owns major real estate all across Canada. Its principal asset is Place Ville Marie in Montreal. We are also in the shopping centre field and the residential field, and we have a chain of retirement lodges for the elderly in Ontario, the Prairies provinces and British Columbia. Our total assets amount to approximately $250 million, and we are a publicly listed real estate company. Control of the company rests with an English corporation which owns approximately 54 per cent of our outstanding stock and approximately 25 per cent is in the hands of the general public.

With the permission of the Chairman, I would now like to read the summary of our recommendations to the committee.

Senator Haig: Before you start, where did you get the name "Trizec"?

Mr. Hay: Trizec is a concoction; "tri" is for three parties, the "z" is for Zeckendorf, the "e" is for the Eagle Star Insurance Company, and the "c" is for Covent Garden Property Company—these three being the original investors in the corporation.

The Chairman: This is the best way of getting a name that the Company's Branch will not object to.

Mr. Hay: On page one of the brief, we have commenced the summary of our proposals.

GENERAL

1. The legislation reflecting the White Paper as finally decided be brought in over a period of years to avoid undue disruption to the fabric of the economy.

2. During the period of the gradual introduction of such legislation, the administrative branch of the Income Tax Department be given the opportunity to gradually assimilate the very substantial changes in philosophy and tax procedure.

3. Provision should be made under the legislation for the issuance by the Department of National Revenue of binding rulings based on stated facts, so that taxpayers may proceed safely with proposed actions under the new law.

CAPITAL GAINS

1. Capital gains and losses should be made subject to the Income Tax Act.

2. Capital assets (which by definition would give rise to capital gain or capital loss) should

be defined as all assets not otherwise held primarily for sale to customers in the ordinary course of business.

3. Difference should be acknowledged between the taxation of short term capital gains and losses and long term capital gains and losses, but no differentiation should be made between closely and widely held Canadian corporations.

4. Short term capital gains and losses should be those arising from the sale or exchange of capital assets held for less than one year and such short term gains and losses should be fully brought into income and otherwise taxed under the Income Tax Act in the same way as other business income.

5. Long term capital gains and losses should be those arising from the sale or exchange of capital assets held for one year or more and such long term gains and losses should be brought into income at 50 per cent of the amount of the gain or loss and otherwise taxed under the Income Tax Act in the same way as other business income. The effect of this will be, for taxpayers in the 50 per cent bracket, that long term capital gains will be taxable at 25 per cent and long term capital losses will be deductible to the extent of one-half of such losses.

6. The cost basis for capital gains and losses as established on the valuation date should be the higher of the historical cost or value of each asset on valuation date, with no capital gain or loss being recognized until historical cost is achieved.

7. Capital gains and losses of non-residents of Canada should continue to be non-taxable by Canada except where the non-resident taxpayer is carrying on business in Canada or, in the case of treaty countries, has a permanent establishment in Canada from whence such capital gain or loss derives.

8. The White Paper doctrines of tax on unrealized appreciation should not be enacted as law. This would eliminate (a) the five year revaluation rule for shares of widely held Canadian corporations (Section 3.33), (b) the deemed realization of capital gain or loss on individuals giving up Canadian residence (Section 3.40), and (c) the deemed realization of capital gain or loss on the value of gifts (Section 3.41).

9. The deductibility of interest, the adjustment of cost basis for non-deductible interest and other expenses, and generally the whole concept of cost basis of assets for capital gains and losses should be clarified by Government.

10. The rollover provisions of Sections 3.43 to 3.52 of the White Paper, and particularly Section 3.47, should be substantially amended so as to permit greater ease of tax free incorporations and reorganizations.

11. More extensive averaging provisions should be provided to equate the impact of the proposed capital gains tax and provision should be made to assimilate and place capital gains and losses under the pool concept in the same manner as recapture of depreciation and terminal loss.

CORPORATE REPORTING

1. Corporations resident in Canada should be entitled to elect to file consolidated returns with chosen domestic or foreign compagnies in which they own 50 per (25 per cent in the case of foreign companies) or more of the voting shares or where consolidation is permitted as a matter of sound accounting practice.

CORPORATE DISTRIBUTIONS

1. The present system of taxing corporate dividends to individual, corporate and non-resident recipients should be basically maintained.

2. No differentiation should be made between widely held Canadian corporations and closely held Canadian corporations.

3. Within the limits hereinafter set forth the taxation of dividends should not depend on the actual tax paid by the declaring company.

4. Inter-corporate dividends from consolidated defined "subsidiaries" should be tax free.

5. All other inter-corporate dividends (other than from unconsolidated foreign subsidiaries owned 25 per cent or more by the recipient company which should continue to be tax free) should be taxed at a flat rate of between 5 per cent and 7.5 per cent.

6. If Government insists on the grossing up rule for dividends the 2.5 year rule of Section 4.27 of the White Paper should be eliminated.

PROPERTY EXPENSES AND CAPITAL COST ALLOWANCE

1. The proposals of Section 5.17 of the White Paper should be cancelled.

2. All profits and losses on real estate account should be fully off-settable against all income, particularly in the case of taxpayers

engaged in the property business. In particular, capital cost allowance, interest and property taxes should be fully deductible in the computation of income to all taxpayers, including particularly taxpayers in the property business.

3. The suggestion of the White Paper that a separate class of property for depreciation purposes created for each rental building that exceeds $50,000 or more should be eliminated.

4. The pool concept for recapture of depreciation and terminal loss should be retained and should be extended to capital gains and losses.

5. Whatever new rules are enacted pursuant to the White Paper should not apply to real property now in existence or to projects for which commitments have been made as long as the beneficial ownership of such real property and/or projects continues to be substantially vested in the persons presently owning same.

That is the summary of our recommendations to this committee, Mr. Chairman. Mr. Phillips and myself will be pleased to answer any questions.

Senator Laird: Might I raise the question, Mr Chairman, that I have raised before regarding the proposal for advance rulings from the Department of National Revenue?

Perhaps I should direct this question to Mr. Phillips, for a couple of reasons: to make him earn his counsel fee!; and because I understand that he has had training in a good law office.

Mr. Phillips, if you have had experience with the American practice of getting advance rulings, you will note there are two disadvantages: one is the length of time it takes to get them; and the second is that if subsequently you vary even moderately from the facts as laid down to get the advance ruling, then you get no benefit from the ruling.

Having that in mind, do you still feel it is desirable in Canada to promote the proposition of getting advance rulings on tax matters?

Mr. N. F. Phillips, Q.C., Counsel, Trizec Corporation Limited: I certainly do. First of all, the time element for rulings in the United States from time to time has been inordinately long. However, there are a very large number of rulings which are issued reasonably rapidly when the facts are simple. This is because some medium powers are given to the local departmental offices to issue rulings which are binding.

Finally, even in those cases where it takes a long time to get it, where you are dealing with very large re-organizations and matters of that nature, it may take a long while, but at least you can tell your shareholders, file a proper prospectus and generally carry on business knowing where you stand. The fact that it takes a while to get it does not militate against the tremendous advantage of getting it.

As you know in Canada now we get quasi-official rulings by letter, which are morally binding, but technically not. Amongst other things it is almost impossible to describe what you have got, as it has no real legal basis. However, practically you know that you should be all right.

Yes sir, I heartily support it.

Senator Laird: I am very happy to get that point of view. My experience has been rather fortunate across the border when we deal with this. If we found any variation from the original facts submitted this might produce a different results than the original one.

Mr. Phillips: To a certain degree an administrative hardening of the arteries sets in in the rulings division. As we say in the major part of our brief, if legislation is enacted it should be so phrased as to induce rulings, rather than prohibit them.

The problem is not with the basic point that we should have rulings, but basically administrative so as not to become over-cautious and effectively destroy the usefulness.

The Chairman: In your first item under capital gains you say capital gains and losses should be made subject to the Income Tax Act.

I understand the words, but what do you mean by this? Are you opposed to a separate capital gains tax which would not identify capital gains and losses with income, or do you think that it should be incorporated as part of the Income Tax Act?

Mr. Phillips: We consider it not to be logical to tax certain capital gains and losses under a separate statute. They are a form of receipt, gain or profit which should be subjected to tax, more or less.

A large portion of the rules of the Income Tax Act could be brought to bear upon them. We suggest, however, that particular defined

types of receipts, capital gains or losses should be treated in different ways and at different rates, both for gains and losses.

The Chairman: If you leave the capital gains provisions in the Income Tax Act then you bring them into that area of grossing up and integration, or you may.

Mr. Phillips: Perhaps you had better ask me the question again, sir; I am not quite sure I got the point.

The Chairman: Under the White Paper proposals capital gains are treated as income, in the same manner as any other form of income. Therefore, when capital gains are achieved they become part of that process of grossing up to the extent that dividends are declared. They are part of the income.

If they are placed in a separate statute it is separated, leaving one tax of a fixed amount with no correlation to any of the other provisions of the Income Tax Act.

Mr. Phillips: There are a number of methods of achieving that. We could follow a quasi-American system which is, in so far as short term gains or losses are concerned, that they are treated in the same manner as all other income. In the case of what we term long term capital gains and losses this brings them into income at half the amount and treats it from there on as ordinary income.

Therefore your grossing up procedures and everything else flow, but only on half the gain or loss, as the case may be. Were we to do it the other way, which is equally conceivable, capital gains and losses would be treated outside the Income Tax Act. Presumably if we take the corporate structure we would create a kind of capital surplus which would be distributable by dividend but would also not fall under the Income Tax Act.

You would remove the whole treatment of capital gain and loss from the Income Tax Act, both at the receipt level and distribution, but I do not think this is practical.

Senator Everett: One of the problems that has been put forward to us where capital gains are part of the income tax structure is that by virtue of the deductibility of capital losses from general income there could be wide variations in government revenues from time to time. On the other hand, if the capital gains tax was a separated tax, the deductibility of capital losses would be . . .

The Chairman: Limited.

Senator Everett: . . . limited to the amount of gains that the taxpayer achieved. So there would be less deviation from year to year in government revenues, which I think you can understand would be very dangerous from time to time.

Secondly, you yourself point out in your brief that if you make capital gains part of the Income Tax Act, even though you halve the rate, you are going to have special averaging provisions for that purpose. You go so far as to suggest that you use a pool concept, in the same manner as to recapture depreciation and determine a loss.

I think your points are well made, but it seems to me that you could accomplish what you desire by saying that gains of a certain type—I think you define them up to one year—are income and come under the Income Tax Act. However, gains over that base are capital gains, separately taxed and the capital losses can only be deducted from capital gains.

I have not really put it as a question, but I wonder if that approach does not accomplish what you set out to do here, without the wide deviation in government revenues, which might be very dangerous under an income approach?

Mr. Phillips: I have no figures nor means of projecting exactly what the quantum of variation of government revenue levels would be because of this type of situation. However, the result of this separate tax from the economic point of view of any given taxpayer would be that if he suffered a real economic loss, what we may term a capital loss, he would not be able to offset it unless he was able somehow to find within an appropriate defined period of time a capital gain.

At least in the presentation of this brief it was felt that the general theory—Trizec is not against all the principles of the White Paper—is the concept that one should look to a certain degree at profit and loss in the big sense, which is better served if you bring in the concept of capital gain and loss with other income but in varying percentages or degree. I cannot answer you, sir, on the question of the risk to government finances, except I would think there is probably sufficient flexibility to adjust it without adjusting it at the cost of the taxpayer.

Senator Everett: We had evidence from the Richardson company last week, taking into account the wide swings in the stock market, and especially the most recent downswing,

that the cost to the Government of the capital loss provisions, if deductible from all income, would be almost catastrophic.

Mr. Phillips: If that is the case, I am not aware of these figures. The way it could be handled, perhaps in the middle ground, is not to have two separate taxing acts, but perhaps to limit, it within certain degrees, to the offsetting of certain trading capital losses, say on stock market account, against anything but stock market profits. One begins to get into the area of perhaps certain specific restrictions in order not to destroy the fabric.

Senator Everett: Would you not agree that under your scheme capital profits are taxed at the top marginal rate, and capital losses are likely to be taxed at a much lower marginal rate for the same taxpayer making the same non-capital gain income?

Mr. Phillips: Again I think I have to turn to the question that it depends which parts of the brief are accepted and which are not. If you go to the pool concept, you do not really realize capital gain and loss until you have exhausted the pool, in the same way that you do not realize recapture of depreciation or terminal losses until you have exhausted the pool. I cannot answer your question unless I know whether we do or do not take the major premise of the pool.

Senator Everett: Is it not true that under the pool concept you could defer the capital gains tax in the case of a corporation ad infinitum?

Mr. Phillips: We would be legally restricted from taking capital losses or depreciation or terminal losses until you have exhausted the pool. It all depends on whether you look at the bottle half full or half empty. If you are making lots of capital gains, yes, the Crown is probably losing tax it would otherwise collect. On the other hand, if there are capital losses being taken, it defers the realization of the capital losses. As a real estate company, we adopt the pool concept vis-à-vis real property, but I am not sure it is at all practical vis-à-vis other types of assets. Certainly it is not within my competence to say you could use the pool concept for, say, shares of companies, that everybody's share investment could be treated on a pool basis. I am sorry, I cannot say.

Senator Hays: Under the present law defining capital gains, your particular company would not receive many benefits from capital gains. In other words, what is capital gain to one may not necessarily be capital gain to another.

Mr. Phillips: That is right.

Senator Hays: In your $250 million in resale and purchase of assets, you would not benefit under the present capital gains, as I might if I had held a piece of property for a certain length of time. How much have you earned in capital gains under the present system?

Mr. Hay: Perhaps I might answer that. We are not a trading company. The assets we have at the present time have been held since their development or purchase by us. We do not sell as a matter of policy. We are purely an investment company.

Senator Hays: But if you did sell and sold more than one or two, the way it is defined today it would not be a capital gain. This is your business, or could well be established as your business.

Mr. Phillips: I would say that we would strongly resist any suggestion that the assets we held are held for trading purposes. If the Crown thought differently, presumably we would be before the courts. We have taken the position to date that we are an investment company, and I think the facts bear it out.

The Chairman: On that point, Mr. Phillips, if we bring in capital gains, your investment position goes out of the window. A gain is a gain.

Mr. Phillips: A gain is a gain.

Senator Hays: You would benefit under this, but under the old system you might lose your case in court.

Mr. Phillips: If I may put it to you respectfully in this way, we think probably we would win on our facts. But this company in presenting its brief has felt, as a company, that the imposition of a capital gains tax is proper...

Senator Benidickson: We cannot hear you.

Mr. Phillips: We think the imposition of a capital gains tax is proper, as the brief says. Whether we might or might not as a company have been fully taxed or not taxed at all on a particular transaction was not within the aegis of our thinking when we presented the

brief. We felt the proper thing was to impose a tax on capital gains.

Senator Hays: In accepting the capital gains tax and saying in your brief you think there should be a capital gains tax, how do you, in accordance with the White Paper, define capital gains? It would certainly be different than it is today.

Mr. Phillips: It would be arbitrary, in the first place, and not open to almost unintelligible attempts in trying to fathom the intentions of a given taxpayer. There would be certain rules, which in most cases would be relatively easy to find out. In other words, if a particular asset was held for less than a year it might be technically a capital asset, but it would still give rise to full gain or loss upon sale as being short-term. If it was held for more than one year it would in most instances be quite easy to determine whether it was a capital asset subject to the lower rate, and we have excluded that—property held primarily for sale to customers in the ordinary course of business, which would be groceries in a grocery store or houses by a company building and selling as it finishes building. This is, respectfully, a test that seems to have met reasonably well most of the questions in the United States, and there is a markedly small amount of case law on determination or definition of capital assets, considering the size of their country.

Senator Hays: I would like to ask you, Mr. Chairman, how you define capital gains under the White Paper. What is capital gain and what is not capital gain?

The Chairman: First, the White Paper does not tell you.

Senator Hays: No, so you cannot debate it if you do not know what a capital gain is.

The Chairman: Well, you deal with that in legislation if there is to be a capital gains tax. You are asking what I think it is. I think it is the difference between what you pay for something that is in the category of a capital asset and what you get for it.

Senator Hays: That is not the case today.

The Chairman: No; first, because you do not have a capital gains tax as such. They rather approach it from the point of view of the nature of the operation you are carrying on. If you are carrying on an operation that looks like a business, any gain in that business is income. The courts have held that if you buy for investment—and there have been cases, and some recent ones that I saw—where the court has ruled against the minister when he was trying to assess for income the gain in real estate transactions, on the basis that the asset has been acquired for investment.

The Chairman: It does not take much to move you from investment to being subject to income tax. They search very carefully.

Senator Hays: It is no longer capital gains. Mr. Phillips, you must have defined how you feel capital gains is going to be applied in your brief. It must be very general and very broad in the real estate business. If capital gains was defined as it is today then you possibly would not have any gain out of the capital gains.

Mr. Phillips: That is right, sir. We are not saying that we would be better off or worse off as a company in respect to the suggestions of this brief. What our company is suggesting are broad and equitable changes to the policies which the White Paper has set forth.

The Chairman: The pool concept might defer the payment of capital gains tax on your capital gains.

Mr. Phillips: It also might, as mentioned earlier, defer the taking of the capital losses. The pool concept perhaps has the advantage—I had better be careful on this—of avoiding the wide swings up or down in Government revenues. The pool concept, in regard to all of the changes, as long as the pool is in existence, is the cost basis of the remaining assets.

Senator Hays: The way it is defined today, if I owned a township of land and I had held it for 50 years and decided to sell it off in small lots it would not be capital gain, but if I sold it in one piece it would be.

Mr. Phillips: I would think, sir, that under our propositions the exact same results would take place. If you broke it up into small pieces to be sold to customers in the ordinary course of business it would give rise to ordinary income.

Senator Hays: Therefore capital gains should be defined in the White Paper. What are we talking about? I think it is a pretty grey area.

The Chairman: The area of capital gains in real estate existing under our present law is very, very small.

Senator Hays: That is right, I do not think people realize this.

The Chairman: If you exclude principal residences and homestead property the only other place where you may try to qualify, if you could establish this, would be investment.

Senator Molson: Could I ask if the company has not had any test of this matter as far as Trizec Corporation Limited is concerned.

Mr. Hay: No sir, we have had no occasion where this has been tested.

Senator Benidickson: You have been building and not selling.

Mr. Hay: That is correct. To my knowledge we have only once sold a property which we acquired and on that occasion it was sold the same day because it was acquired in connection with the acquisition of another asset.

Senator Benidickson: So the tax you have been paying is simply a tax if your income from these properties has exceeded your expenditures.

Mr. Hay: Yes, we have in effect not paid any income tax since incorporation in 1960.

Senator Molson: On Page 15 of your brief you refer to capital gains, and you say:

> the taxing systems have always acknowledged the merit of applying different taxing procedures to current income receipts and capital appreciation or depreciation.

I still find it a little difficult to reconcile with your opening paragraph on page two:

> Capital gains and losses should be made subject to the income tax act.

If you have different taxing procedures doesn't this create quite a complication if it is under the Income Tax Act.

Mr. Phillips: Perhaps it would be better if you look at the word procedures in a larger way. We meant that once brought into the Income Tax Act the gain or loss should be treated differently than other types of income with fundamentally a difference of application of the rate of tax on the gain or loss and in a subsidiary manner the concept of the pool, which is a secondary suggestion. The major suggestion of the difference in rates applicable to long term capital gain or loss does not militate against bringing it into the Income Tax Act.

We had not considered the removing of capital gains and losses outside of the Income Tax Act in a statute and treating it differently. I think I can speak for the company that we are not for or against it, but it was just not contemplated by us.

The Chairman: The Richardson people have advocated a 15 per cent rate and a limitation of the losses to the gains and possibly correlating them and maybe throwing in a little bit of the United States position where a negligible amount of your earned income may be resorted to each year.

Senator Molson: I thought you might have referred to the last sentence on that paragraph, page 15 and tried to correlate that to paragraph one on page two.

May I invite a question or an answer from Mr. Phillips. The concluding sentence in that paragraph at the bottom of page 15 says:

> The divergence of the White Paper on this subject can only reduce the funds available for the expansion of Canadian development.

If that is important for Canada that the capital funds should not be diverted then which one, in your opinion, should prevail? Are you as much in favour of a capital gains tax as you appear to be on page two.

Mr. Phillips: Mr. Chairman, in presenting the brief of this company, which reflects the decisions of this company, the feeling is that it is proper—I realize that is a general word—that capital gains and losses should be brought into the taxing system and not, as has been mentioned earlier, on a somewhat haphazard basis either totally excluding or totally taxed. It is felt that this would serve the interests of Canada, that if capital gains were taxed and long term capital gains and losses were treated at a lower rate that this would not hurt the Canadian economy and might aid it.

The company did feel that full taxation at the same rates, as suggested by the White Paper, would be a very serious inhibition to the development of Canada.

The Chairman: You have practically parallelled what the Richardson people have told us last week, so you are in good company. They said that the 25 per cent rate would discourage the type of investor who likes to start at the beginning in a growth situation and follow it up until it reaches an investment level. He then wants to get out and

repeat the process. There is a difference in mentality which is interested in picking up at the established investment level. They said that a 25 per cent rate would be so high that these people would stay with their investment instead of selling out and that would deprive the capital market of funds which ordinarily come into it from people who keep repeating this process. They also said that a 15 per cent tax is one which they would be ready to accept, because the level would not be that great.

The White Paper recognizes the difficulty in the high capital tax rate because that is why they say they introduced the deemed realization. They also say that the people would otherwise be locked in so they are going to unlock them whether they want to be unlocked or not, by the deemed realization. There seems to be some logic in that. I was interested because your explanation which I assume was made without having even read the Richardson brief, because it just about parallels what they said. That is, the rate of capital gains tax is a very important consideration.

Mr. Phillips: I think I can speak for the company. We suggested 25 per cent, but we are not married to that rate as being the best. It is certainly beyond the competence of this company to determine what is the best. We suggest 25 per cent, but perhaps it could even exceed that. Perhaps it should be lower. We really have no way of knowing.

Senator Hays: Mr. Phillips, how should capital gains be treated if the market is up on valuation day or if it is down? For example, say the market happens to go down or that we have a recession, then on a small given building of $20,000 you would have a loss if on revaluation day it was valued at $15,000. That would be a $5,000 loss. That would be a loss to the company. But if it was revalued at $25,000 that would be a $5,000 gain. Is that right?

Mr. Phillips: If you start with a cost basis of $20,000 on valuation date and subsequently you sell it for $25,000 that would be a gain. Is that what you mean?

Senator Hays: In that case you would have a gain, but if you sold it for $15,000 you would have a $5,000 loss.

Mr. Phillips: Yes.

Senator Hays: On all your properties.

Mr. Phillips: I presume so, yes, sir. I am not sure I understand your question.

Senator Hays: You are defining capital gains as you think they should be defined, but suppose they are defined the way they are today. Suppose the regulations don't change the definition of capital gains.

Mr. Phillips: If I may say so, sir, our answer is divided into two parts. We could conceivably live with a capital gains system of taxation without defining capital gains.

Senator Hays: But under the present situation you don't pay capital gains.

Mr. Phillips: We could keep the amorphous, vague principles that are now at hand and impose a tax on capital gains based on them. To the company presenting this brief it seems that if we were to take the proverbial bull by the horns and attempt in some way to define what is and what is not a capital asset, and what is and what is not a short-term holding of an asset, that might be a consideration warranting examination.

Senator Hays: In your brief you define it rather as the Americans define it.

Mr. Phillips: Not so much because the Americans have defined it that way but rather because, from my limited experience, it seems to work fairly well in an area where we have had nothing but massive litigation. The problems in the United States arise under things like tax reorganizations. There are a lot of areas there, but I think upon examination it would be seen that the amount of litigation on what is or is not a capital gain is remarkably small considering the size of their country; and, granted, it is arbitrary. They use the six-months rule and things like that. But it works.

Senator Aird: But they know they are going to collect some tax in the United States and this makes the department there less keen to pursue the taxpayer to determine whether it is taxable income or a capital gain. They are going to get something anyhow.

Mr. Phillips: I cannot say yes, but I assume that is correct. The imposition of a tax on what we have termed capital gains, be capital gains defined or not defined, is only the beginning of a vast area of complexity in my opinion. Because no sooner do you get into the taxation of capital gains and losses than immediately you have to figure out what to exclude. Actually, what we have called the

roll-over provisions they in the United States call the reorganization principles, and these are of monstrous complexity.

The Chairman: Mr. Phillips, we have been making some assumptions here that perhaps we should not have been making. We have been assuming that the Income Tax Act or some related act might define capital gains in such terms that all or part of it would be income. But in the corporate approach to capital gains and to income from operations it does not necessarily follow that the two are the same and mean the same thing.

I mean capital for corporate purposes and corporate statements under the provisions of the Corporations Act may still remain what it is. The Income Tax Act is only putting a certain characteristic on certain funds for tax purposes.

Mr. Phillips: I am not an accountant, sir, but I believe that under the accounting principles they don't, as they used to in the past, distinguish between capital surplus and earned surplus.

The Chairman: That has long been an American practice. Everything that is surplus they lump into surplus.

Mr. Phillips: Even now under our way of doing it by the time you get around to your tax considerations you have to break up again that which they had put together.

The Chairman: I was thinking in terms of the treatment of dispersement of moneys. If I pay a dividend, no matter what it came out of, it is income in the hands of the person who gets it.

Mr. Phillips: On that point, sir, which is not in this brief, may I take a moment to just make a further point? Although I cannot speak for the company, I think all concerned would be delighted if the whole integration system were to go and we stayed more or less in our present system. We feel that some more useful procedure could be designed for the distribution of capital surplus than the procedure of capitalizing the capital surplus, issuing preferred shares and redeeming them.

Senator Benidickson: Which is generally at the rate of 15 per cent tax.

Mr. Phillips: If you are taking earned surplus and making it into tax paid undistributed income. If you have a capital surplus on hand from a capital gain and don't have any earned surplus, you can just capitalize your capital surplus if you have preferred shares and redeem them. The American system is uniquely simple on that point. They just say that if the dividend is out of earnings and profits it is taxable. That is the end of it. The question that the Chairman raised is if we make capital gains subject to partial tax with, say, dividends out of that gain, it should be treated in the same way as ordinary income. Presumably, under the procedure of this brief, yes, if you eliminate integration, because the benefit on the long-term gains and losses is already taken by taxing only half of it. Thereafter the net result could be treated the same way as any other earnings and profits in surplus. This is a matter we have not studied exhaustively. It is based on certain premises, and the major idea accepted among us is, first of all, total elimination of the integration concept. Otherwise, none of this makes sense.

The Chairman: I don't want to beat this question to death, but, if you eliminate the capital gains feature from the grossing up and integration and the deemed realization and you create a separate category for small businesses, a very considerable strength or support for grossing up and integration would disappear, would it not?

Mr. Phillips: I think so, yes, sir. I think alternately to what was just said before that there would certainly be nothing inconsistent, if you leave aside integration for a minute, for putting in a tax on capital gains and still segregating the resultant capital surplus and perhaps being capable of distributing it without taxation. There is nothing inconsistent in that theory. There is nothing equally inconsistent in treating the result as ordinary income. These become matters more of policy than anything else.

The Chairman: Arising out of one thing you said now, if you tax income, what I have left after I pay the tax is mine and I can use it in any way I like, and I do not have to go through the wringer of taxation again in the use of that money. As a result of the use I may make more income. But if I pay a capital gains tax, why should not what is left be mine in the same sense, free for me to use in any way that I like? You suggested that the residue might ultimately come into the income tax field.

Mr. Phillips: Well, then, I led you astray, senator. I did not mean that. I was talking at the corporate level. Certainly from the point of view of the individual, I did not mean that.

I meant the treatment of corporate surpluses in a distribution.

Senator Everett: On page 6 in items four and five, you suggest that intercorporate dividends from a consolidated subsidiary to its parent or from a foreign subsidiary in which the parent owns more than 25 per cent of the shares should be tax free, but that any other corporation dividends should be taxed at either 5 per cent—and you use the word—and 7½ per cent.

Mr. Phillips: Between 5 and 7½ per cent.

Senator Everett: I wonder if you could give us the rationale for that statement?

Mr. Phillips: It is easy to give the rationale for the consolidation. Presumably if you are filing consolidated returns at the corporate level, you are paying a net tax as though you were dealing with one company. That is the basic concept. Therefore there should be no additional tax on moving moneys within the consolidated unit, just as there is no logic in why anything moved in the consolidated unit should result in tax. Incidentally, that would apply to capital transfers and anything else. In so far as the 5 to 7½ per cent tax is concerned, it is perhaps a more controversial point. There seems to be the company, senator, a difference from where you bring up intercorporate dividends from major holdings and the general type of investment company or fund or anything else that just invests in the market, holding small positions and deriving income therefrom where they are just in investment positions of a relatively minor nature, so minor that they cannot consolidate at a different level. It seems that a fair source of revenue to the Crown without disrupting the fabric of the investment community could be reached by taking a flat tax on intercorporate dividends on small holdings. Since in this brief we recommend certain things that we assumed, as compared to the White Paper, would deprive the Crown of revenue, we thought perhaps we ought to try to introduce some ideas to compensate and show where we thought the proper imposition could be made, and this is one of the areas where the Company though a proper imposition could be made.

Senator Everett: But are not those dividend revenues taxed on distribution from the parent company? Is not this the concept of the present act and indeed even the White Paper attempts to maintain that concept, that in a chain of corporate shareholdings, dividends can pass up tax free, but when there is a final distribution to the shareholders, if the shareholder is a person, the tax is exigible at that time.

Mr. Phillips: Yes, we felt that that is a fair and logical statement for the consolidated entity, but the difference in factual division between a company holding small holdings in another is such that the relationship between them is so remote that very often, as I said earlier, they know very little about each other, and the shares are bought either for gain or loss on the market or for the dividend yield, and at that point this Company felt there was a certain logic in saying that you do not need to carry to the extreme the concept of free intercorporate dividends. In fairness, it would be ultimately taxed and the Crown would take up a small amount as it went down through the chain. It is more practical than theoretically reasonable, but it would not affect the investment community to any substantial extent if we had a small 5 to 7½ per cent tax on intercorporate dividends on investments.

Senator Everett: Could we have a situation, Mr. Phillips, and I don't know if this is possible, in which there was a chain of, say, four companies passing dividends along, not being consolidated, in which the 5 to 7½ per cent tax would be exigible without credit. This would be a mounting tax.

The Chairman: If you had four companies, it would be 20 per cent.

Senator Everett: Well, it would be 5 per cent of 95 per cent, so, like the depreciation schedules, it would be a diminishing balance, but it would still be a fair tax.

Mr. Phillips: We agree with you, sir, and I can only answer that in two ways. The first is that the chances of small holdings in a line astern like that is probably not going to happen very often, and secondly if it was a serious problem, I suppose an exclusion could be made after the second round, or something, and that thereafter they would pass tax free, but the philosophy, if there is a philosophy, is not one that is entirely theoretically logical, as much as practically not damaging and at the same time raising a fair amount of revenue.

Senator Molson: What about mutual funds? They would all be taxed?

Mr. Phillips: Yes, sir.

Senator Beaubien: You would throw the mutual fund industry out of business the first day.

Mr. Phillips: I cannot argue on that, but I cannot imagine that a 5 per cent tax on the amount of a dividend or even a $7\frac{1}{2}$ per cent tax would be such an onerous imposition as to throw mutual funds into a decline. However, we are talking of something on which I am in no position to comment. I don't know.

Senator Everett: What we are trying to discover in a very good brief is the rationale for making certain of these statements. Would I be misquoting you if I said that in the case of tax on intercorporate dividends, the rationale is the fact that you think that this can be gotten away with by the Government.

Mr. Phillips: You have put me in a difficult position. I would have chosen to phrase it somewhat differently. But the situation is that we thought that there was a real difference between the intercorporate body which is a big consolidated unit and the theory that just because one company received dividends from another company, it should get it tax free. After all, if I may respectfully say it, we have now given 20 per cent tax credit to individuals. Presumably, this is because it is some compensation for the fact that otherwise there would be double taxation. No one has ever said that the 20 per cent is exact or entirely right or that it gives full compensation. Some say it is too much; some say perhaps it gives too little. This new idea is merely suggested as a middle ground for a fair revenue raiser without disrupting the corporate fabric.

Senator Molson: The impact of this would possibly be heavier on the smaller corporate unit than the larger. A smaller company is more liable to have a minority interest holding as an investment perhaps than a big company.

Mr. Phillips: Senator, if we take dollars, if you have an investment company—I do not know how we define "small" or "large," but with say, $100,000-worth of dividends a year—if it now gets $100,000 tax-free, and after our suggestions would get somewhere between $92,500 and $95,000, that does not seem to be a monumental penalty.

I might also answer that if one looks at the large number of funds and investment companies that hold foreign shares, where they are fully taxed on the dividends, it has not seemed to dreadfully inhibit these funds from investing in foreign shares. Very little attention, as far as I can see, is paid to the taxation of dividends as compared to the worth and quality of the shares and the potential for gain.

Senator Molson: I am thinking of small businesses that make some modest investments. That is really what I am thinking of. They would have a tax which probably the larger corporation would not have.

Senator Benidickson: Because of the small percentage of the holding in the corporation.

Senator Beaubien: Let us say, Mr. Phillips, a mutual fund has a dividend of $100,000 coming in a year. In the ones I am on the board of and know something about, its expenses would be something like $70,000, and that would leave $30,000 in to be distributed to the shareholders, but under your minimum suggestion that would be reduced, because 5 per cent of the $100,000 would have to be paid to the Government. So instead of having $30,000 they would have $25,000, which makes a tremendous difference.

Mr. Phillips: Respectfully again, senator, in other parts of the brief, something which the white Paper did not deal with is that once you get into the question of under certain circumstances taxing intercorporate dividends, all the rules will or at least should change, for instance, on the deductibility of interest and expenses. There are a certain number of expenses that are not deductible on the theory that you are buying shares, the income from which would be exempt. Once you start to wholly or partially tax intercorporate dividends, under the integration system, all the rules, presumably, are going to have to change as to deductibility.

In your case, sir, take the rule we have set out here. It would seem a logical extension that if there is a partial and small tax on these intercorporate dividends to your fund, and at the same time a small and partial deduction of equivalent amounts should be allowed for now non-deductible expenses. I am not an accountant enough to be able to figure out where you get to.

Senator Beaubien: You are suggesting, Mr. Phillips, that we put in a law and change all the other rules that cancel out the new tax you suggest?

Mr. Phillips: The new rules are bound to cancel out the tax because at the moment, if I may return to what we are here involved

with in the White Paper, if you put in the White Paper integration, one thing is absolutely certain, that all the rules on deductibility of expenses, like interest on cost of acquiring shares, must change. The question is asked in the brief, for instance, senator, if a company borrows money to buy 100 shares of Company "X" and Company "X" is a fully tax-paying company so that the dividends from Company "X" turn up tax free in the purchasing company, and at the same time purchases 100 shares of Company "Y", which does not pay any taxes, so that the dividends from Company "Y" are fully taxable to the purchasing company, will the interest be deductible in one case and not deductible in the other case? Will it be deductible by annual test or partly deductible, depending on the corporate profits of the declaring company? These are all the questions.

To come back to your point, sir, the same questions will have to be raised here, only on a smaller scale. It would not be elimination of the tax but a proportionate offset.

The Chairman: It is quite obvious that the greater the deductibility, the less the corporate tax; and the less the corporate tax, the less the creditability and the more the shareholder will at the marginal rate.

Mr. Phillips: In which case, certainly in so far as this brief is concerned, we did not try to re-write all the considerations. It is a matter of decision whether because of the rate of 5 or 7½ per cent being a reasonably small amount, perhaps it would be deemed to be a tax-free dividend for non-deductibility of expenses. I cannot say if some portion would be given, or how you would handle it. Perhaps the net result would not be, in some cases, 5 to 7½ per cent, but it might be in that type of investment company that does not have expenses. After all, $70,000 of expenses for $100,000 of dividends, that may be for a mutual fund, but there are many investment companies spend an awful lot less.

Senator Beaubien: I was thinking of mutual funds.

The Chairman: Mr. Phillips, in paragraph 3 on page 6 you say:

> Within the limits hereinafter set forth the taxation of dividends should not depend on the actual tax paid by the declaring company.

Would you expand that?

Mr. Phillips: Pardon me if I leave out the first part for the moment and say that we are trying to reinstate the existing rule. At the moment the taxation of dividends does not depend on the taxes paid by the declaring company.

The Chairman: Then you favour the present method which is a percentage deduction of the dividend received from tax?

Mr. Phillips: Yes, I must apologize to the committee. I think the words "within the limits hereinafter set forth" were meant to refer to paragraph 6, which was a sort of last line of defence, that if we really have to go to basing it on the actual tax paid by the declaring company, we should eliminate at least the 2½-year rule, but that is a very subsidiary recommendation. This company is strongly for the elimination of the integration concept and perhaps the substitution of some of the other suggestions. Does that answer your question, sir?

The Chairman: Yes. I concluded you were addressing yourself to the present method of giving some benefit to the shareholder, and you really had in mind the method of a 20 per cent deduction from tax. I took it this was intended to support the continuance of that method.

Mr. Phillips: Yes.

The Chairman: Obviously, if you do that, you are contributing substantially to the demolition of the integration concept.

Mr. Phillips: We would not deny that.

Senator Hays: If the White Paper becomes a fact and under the regulations the present definition of capital gains does not change but remains exactly the same, would you then agree that what you have proposed would be the right approach?

Mr. Phillips: We could presumably live with a non-definition of what constitutes capital gain and what constitutes an ordinary gain, or capital and ordinary loss. The system could not support a non-definition of what constitutes long term and short term.

By definition someone would have to say somehow which is long term and which is short term gain. That minimal definition must be there.

Senator Hays: This would have to be in the recommendations.

Mr. Phillips: Yes. Although we recommend against it, we could conceivably live with just

leaving what constitutes a capital asset to the rules of the courts.

Senator Hays: After reading all the briefs it seems to me that everyone defines capital gains as he hopes the regulation will. However, if the rules of the game are exactly the same I do not think there will be much difference.

Mr. Phillips: They are not the same, sir. I can give you a very simple answer: at the moment Mr. X who trades rather actively on the stockmarket, buys and sells shares or blocks on a daily basis, under the current administration receives capital gain. Under our system he would be fully taxed, so it is not the same.

Senator Hays: One of the few definitions says this will be taxable and considered as capital gain, which it is.

In the real estate business, which you are in, it is not clearly defined.

Mr. Phillips: You are right. We do not make a special plea on this point, but it does not seem logical to those in the real estate business that Mr. X, trading a hundred trades in a day does not get taxed and someone who makes a few trades over a five-year period does.

The Chairman: It is a philosophical approach. I have said previously that I am not sure that taxation and the principles of taxation are synonymous with logic.

Mr. Phillips: The 5 per cent on dividends seemed a more practical method to the company presenting the brief. It is not explicitly logical, but it seems to the company to be a good system.

The Chairman: As I read your brief I found the points to which it is directed very clear. I wonder if any of the senators have any other points that they would like to take up? If not, then I put it up to you: Is there any point in your brief which we have not touched upon this morning that you would like to expand on?

Mr. Phillips: Throughout the framework of this brief we have dealt with the general rules applicable to Canadian taxpayers. We left to the end those which most hurt this company. No questions have been raised regarding them. We do not mean by that to incite a question, but we do specifically request that the committee look at the last section, starting on pages 6 and 7, and paragraph 5.17 of the White Paper.

Even within the context of the White Paper real estate investment is, for reasons which are not entirely clear, segregated from the White Paper rules and particularly onerous rules applied.

Even more serious for our company is what might be, but we certainly do not admit it, a proper rule for an individual buying a piece of real estate, applied generally to a real estate company. For instance, we do not have a pool of depreciation for rental buildings which cost more than $50,000, which is just an inconceivable result for a real estate company.

The Chairman: I have checked your item 3 on page 7, where you say that the proposal is that for depreciation purposes a separate class of property be created every time you have a piece of property for rental which exceeds $50,000.

Now, what is the charm about $50,000 and why the limitation to rental property?

What is the abuse, if we may call it that, that the White Paper rather suggests exists and this is intended to cover or, to use their language, what is the loophole which they have created and are now trying to close?

Mr. Phillips: Because in certain instances people have taken things to which they are entitled under the Income Tax Act which somehow or other do not seem to the department to be quite the way it should be, even though it is legally right.

The White Paper would seem to say that everything of this nature is bad per se and done for improper purposes. We resist that, gentlemen, very strongly. This is particularly so in the case of a bona fide, publicly listed, active real estate company. We are not in business to create loopholes nor to take advantage of them.

The Chairman: I was not considering it from that point of view. What is the charm in $50,000?

Mr. Phillips: None, sir.

The Chairman: Is there anything in the conduct of rental, as you may have seen it, that would make this a figure which they should devise?

Mr. Hay: I know of no reason why $50,000 would have any more applicability than

$100,000 or $25,000. We have been unable to understand why that magic number was chosen.

The Chairman: The magic number might have something to do with this: if you had a number of rental buildings at the present time and carried them all in one corporate setup and some of them were profitable and others were not, you could eat up all the revenue by your write-offs. The buildings not earning anything, of course, in that sense could be written off.

However, after all, surely rental income is rental income, wherever it comes from. Once the income is received, this paper would deny you the right to use that rental income really, except in connection with the building from which you received it. It places a limitation of $50,000, that each time you have a building of more than $50,000 and you have it rented you have to treat it as a separate property.

Mr. Phillips: It seems to us that they are looking upon capital cost allowance or depreciation as something vaguely immoral; if you use it to eliminate income you have done something, that, while it is all right under the law, is not quite the right thing to do, which in our opinion is essentially wrong. It is not a loophole. It is a recovery of what has been spent. The capital cost allowance only arises if you have spent the money. It does not come out of nowhere. It is there because you have spent the money to buy the property, to create it.

The Chairman: Was there anything else in these special conditions, Mr. Phillips?

Mr. Phillips: Mr. Hay has asked me to point out something on the last item of our recommendations on page 7. Whatever new rules, if there are to be any new rules, are applied, we would hope that legislation when it comes in would not apply to real property now in existence, or to projects for which commitments have been made, so long as the beneficial ownership of the property remained in the same hands. Under the uranium regulations they said they would allow existing companies to continue on certain bases, and the new rule would only be applied when transfers were made to non-residents. I do not want to get into that. We are taking roughly the same kind of approach. Whatever is done, the new rules affecting the real estate industry should not apply to existing owners of existing properties or projects, but they would start to apply if, as and when the existing holders dispose of them to new acquirers, otherwise our whole structure, which has been based on prior, I think, reasonable assumptions, would be totally disrupted in many areas.

The Chairman: What you are saying in effect is that they should not change the rules and make them apply retroactively where you have embarked and made commitments on the basis of the existing laws.

Mr. Phillips: That is correct, sir.

The Chairman: Other people have made this point on other aspects of the White Paper. We are fully aware of the problems. Are there any other questions? Is there anything further you wanted to add, Mr. Hay?

Mr. Phillips: There is one misprint, if I may point it out. On page 28, the heading says "The adjustment of cost basis for non-residents"; it should be for non-deductibles".

The Chairman: Subject to that, there are no further matters?

Mr. Phillips: No, sir.

The Chairman: We want to thank you very much. One thing I can say is that your brief was so clear that it could be read and we could understand what it was directed at. We know what the points are.

Mr. Phillips: On behalf of the company we thank you, sir.

Mr. Hay: Thank you, senators.

The Chairman: We have one other brief this morning. It is from the Nova Scotia Fruit Growers' Association. Mr. E. W. Peill, Chairman of the brief committee, is going to make the presentation.

Mr. E. W. Peill, Chairman, Brief Committee, Nova Scotia Fruit Growers' Association: Mr. Chairman, I would like to introduce Mr. Paul Gervason, who is with the Nova Scotia Department of Agriculture, who had the task in the last few months of explaining the White Paper and its possible implications to members of our agricultural community.

The Chairman: If you are making an opening statement, I take it that in the course of it you will tell us the functions of the association?

Mr. Peill: Yes.

The Chairman: And what the problems are.

Mr. Peill: Yes, I will include those. The Nova Scotia Fruit Growers' Association represents approximately 600 members. The fruit growing industry as such has a value of approximately $17 million, and is concentrated primarily in Kings County and Annapolis Valley. The income from fruit production accounts for approximately 50 per cent of the total personal income in the county. Those are just a few figures to show that we are concerned, and that it is of importance to one region of our province.

I would like to thank this committee for the opportunity to come here and be heard. The submission of the Nova Scotia Fruit Growers' Association, which you have in front of you, is short and concentrates on certain points which are of major importance to the fruit growing industry. We have tried to avoid incorporating such White Paper suggestions as are being discussed in the briefs from other organizations or individuals, which have already been presented to your committee, and from different angles. When you are dealing with agriculture as it exists in Nova Scotia, you are dealing with a type of business which in its internal structure and operation, and its financial structure, is different from other businesses, and we believe that a drastic change in the taxation policy as proposed in the White Paper should consider existing conditions in agriculture more than it presently does.

I would like just to inject the thought that in Nova Scotia the speculation in land holdings that might take place on the fringe areas of large cities of Canada does not exist. The sale of agricultural property at tremendous profit for real estate development is very limited. The odd building in a town or village might be involved, but there are none of these large development areas where prices will double or triple in a very short time.

We believe that the suggested system is complex, and its full consequences are understood by few. There is a great danger that people who do not understand this law will do great financial harm to themselves by using the wrong approach. We further suggest that it will force farmers continuously to seek legal and accounting advice which they cannot afford. We will see a flood of unrealistic mortgages and sales agreements, and there is a great danger that the incentive to maintain a farm in good condition up to the date of sale will disappear. Unfortunately, the Government has not given us further explanation, nor has the Department of Finance tried to explain and fill in large gaps and injustices, if I may so call them, of the present proposals.

We also believe that the White Paper does not give sufficient consideration to the total tax burden that we already carry. We refer to hidden taxes, gasoline taxes, import duties, municipal taxes, provincial sales taxes, federal sales taxes and finally succession duties.

With your permission, honourable senators, I would like to make a short remark about succession duties, as it will form part of our total tax picture and the social economic environment which we are about to create. On April 25, the Halifax *Herald* carried an advertisement for the Nova Scotia Housing Commission, which I would like to show you. The picture shows a house the commission proposed to sell for $10,000. This is all I would be permitted to leave any one of my children 26 years of age. I am wondering now what ten or 15 years of inflation will do to it.

These are some of the thoughts that form the background of our submissions and we would be pleased to answer further questions and give explanations.

The Chairman: Are you ready to continue, Mr. Peill.

Mr. Peill: If you wish I can read our submissions.

The Chairman: You do not need to do that, because we have been over it. What I would like you to do is deal with some of the salient points in your submission as to how the White Paper adversely affects you.

I notice, for instance, in paragraph 6 of your brief you set out the reduction in tax to the lower income farmers, but then you speak about the new tax bill increasing sharply up to 51.2 per cent for incomes over $21,000. In the area in which you operate what would you say as to the percentage of income of that group?

Mr. Peill: Strictly from a farming sense it is small, and this point was made with respect to capital gains tax. We wanted to point out that while the reduction is there for income tax, when a farmer sells his farm, the capital gains which might have occurred over the last 30 years are fully taxed. He will suddenly be in the 50 per cent bracket.

The Chairman: Wait one moment now. There is a valuation date and that date is sometime between now and when the legislation takes effect. Of course, this is assuming

that the legislation does take a form which involves a capital gains tax. The value which will be the starting point to determine whether thereafter on a sale you have made a gain will be the value as determined on that valuation date. It will not be by reference to the cost at the time the property was acquired, so that the accumulated increase in value or increment along the way will be in your price or your value and what would be taxed would only be the gain or the amount realized over that period.

Mr. Peill: Yes, we realize this, but these so-called gains, if you consider an inflation of just two per cent over a period of 30 years, are significant. We have worked some figures out here, and Mr. Gervason can answer questions on it.

I believe with a farm value on V day of $42,000 and with a two per cent inflation, that any investment over $42,000 will not be sufficient to secure that the owner will not have to pay part of his original investment in capital gains taxes. I do not know if I have made myself clear on this point.

Senator Hays: The starting off point would be the market value of V day.

Mr. Peill: There again is a field which is not defined as yet, the market value or book value. We are going through areas in agriculture where we have made a higher investment which could be realized for this farm the very next day. If you plant 20 acres with a lot of young trees, the sale price is not very high but the investment price is high. The person who wants to buy will say that the orchard is not yet producing, that there are still five years of imput—so there is a wide gap between market value and actual investment value.

Senator Hays: If you die or you are planning to sell out you have to take market value.

Mr. Peill: Yes.

Senator Hays: And the increase would be what is taxable from valuation day.

Mr. Peill: That is correct.

Senator Hays: How do you handle your cash basis on a fruit farm? Can you operate on a cash basis?

Mr. Peill: Yes, we operate on a cash basis, and an investment in trees is an operating expense.

Senator Hays: So if you make a profit you can go ahead and put in another five acres of trees.

Mr. Peill: Yes, they are deductible, but it is now permitted to capitalize a young orchard. In many cases I believe, especially under the proposed rules, it would be considerably better. A man who might show a profit of $3,000 or $4,000 income would pay only a small percentage of tax.

Senator Hays: He could also reinvest it by putting up more trees, fertilizing, ditching, and so on, which would come into his operating expense. If he knew at the end of the year or shortly before the end of the year that there would be a payout already, he could conceivably go on without paying any income tax for 20 years. Is that right?

Mr. Peill: Theoretically this could happen, but whether it would be economically sound is another question. We also have to look at our farm operations as a sound economical unit rather than just trying not to pay tax. If you deduct $2,000 worth of trees in ditching you only save a small percentage of that. The rest is capital which, as the owner, you reinvest. It is only the portion of that tax that is not paid which is saved.

Senator Hays: Are you incorporated?

Mr. Peill: No, I am not personally.

Senator Hays: Are many of the Nova Scotia fruit growers incorporated?

Mr. Paul Gervason, Economist, Extension and Economics Branch, Department of Agriculture and Marketing, Truro, Nova Scotia: There are only three or four that I know of. The rest are a typical proprietorship or partnership operation.

Senator Hays: How many fruit growers in Nova Scotia pay income tax? Do you have that figure for the last five years?

Mr. Gervason: No, sir, I do not.

The Chairman: This is a large question, but any question that relates to the income of a person is an important one to him. While the amount may be small when you measure it against other situations, to the man who has a small income it is important that he be able to retain as much of it as he can. I suppose there is a limit to what he could spend. He must have income in order to live.

If his tax were going to be small he could save 50 per cent of it by expanding and

planting more trees or doing ditching or things of that kind, but the limit on that of course would be the economics of it and whether he needs more threes and ditching. I am trying to look at where the problem fits into the White Paper and whether or not you can tie it in.

Senator Welch: Mr. Chairman, on capital gains, if we took a bare farm, perhaps with some buildings, and you planted, say, 3,000 or 4,000 trees, you are going to be in debt for at least 10 years until they begin to bear fruit. Then you decide you want to sell the whole thing, are you not going to get stripped by the capital gains, because your property then has become very valuable?

The Chairman: You mean in selling the farm?

Senator Welch: Yes.

The Chairman: Yes, the capital gains tax that is proposed under the White Paper would include the gain on the sale of that farm—the gain between valuation date and the date of sale.

Senator Welch: If it is now valued at $5,000, but 10 years from now, when it is covered with nice fruit-bearing apple trees, it will probably be worth $30,000 or $40,000.

The Chairman: That gain would be taxable as income under the White Paper proposals.

Senator Carter: If a person bought unimproved land, if he went out and bought a piece of wilderness and improved it and brought it up, then you have that factor. Then you have unflation coming in as a second factor. Surely, the valuation date should not assess it on its original cost?

The Chairman: You would expect that valuation date would reflect all those factors?

Senator Carter: Yes.

The Chairman: That is why valuation date is a very important process, and to say that you can very informally arrive at value may present problems in 10 years, because the amount that you establish as value may be questioned. The only way to be sure of it at that time would be to have an expert do the valuation.

Senator Phillips: I do not think, Mr. Chairman and honourable senators, that we have paid enough attention to the fundamental question of the application of capital gains to farmers, fruit growers and the like, and I think that with his brief before us this may be the opportunity for me to raise the point I had intended to raise for some time.

Generally speaking, as a younger, growing country, even in our electoral system, even though there may be critisism thereof, we have given special attention to people who are not urbanized or live in the urban areas, and certainly in respect of natural resources we have given incentives and all that sort of thing. I think this committee might well consider the fundamental question, if, as and when we introduce a capital gains tax, as to whether there should be a capital gains tax applicable to bona fide farmers, fruit growers and people who produce our sustenance.

The Chairman: With the limitation, would you suggest, so long as the use character of the farm is maintained?

Senator Phillips: Yes, if maintained.

I think Senator Carter has raised a very important point. What about a farmer or a fruit grower who takes virgin territory and with his own know-how, ability, daring, speculative risk, and one thing and another, simply goes ahead and takes virgin territory and turns it into a farm or fruit-growing area? I am leaving aside, for the moment, Senator Aseltine's point, which is a very important one...

Senator Aseltine: I raised this point the other day.

Senator Phillips (Rigaud): ...I think, on the accretion of value going back to homestead owning over a period of years. I think it would be a highly constructive move on the part of this committee if in considering the whole question of capital gains in the report to be submitted in due course...

The Chairman: In relation to the farming industry.

Senator Phillips (Rigaud): Yes, that we deal specially with farming and fruit growing...

Senator Aseltine: Actual farming.

Senator Phillips (Rigaud): Actual, bona fide farming, and not these gentlemen farmers or commercial farming on a huge scale, and we might even restrict it to the number of employees on the farm or relate it to the family-owned farm, and that sort of thing. But it does appear to me that we have been spending an awful lot of time discussing this

whole question of incentive legislation for capital coming in, and properly so, in my opinion—natural resource holidays, depletions, and the like—and we have not been giving enough attention, certainly in this committee, and I doubt whether they have even touched the subject matter in the other committee—I say I doubt it, but I do not know—to the condition of the very hard core of our people. I am very much impressed by that, having been born and bred in the Montreal area, where I have always been taught that special consideration must be given—from the point of view of economic health and fairness and dealing with our fellow citizens in this country,—to the categories to which I have just referred.

When you deal with an ordinary income tax act, that is one thing. You are dealing with income and maybe the odd special privilege, by way of incentives and that sort of thing. They may or may not have been dealt with fairly in the past, but as you have said before, Mr. Chairman, you have jacked us up and you have said that we are here to deal with the White Paper, and that is what the Senate is doing. We are dealing with that only, and not with the philosophy or fairness of the present income tax. But now when we are dealing with the White Paper and where there seems to be a resignation to or acceptance of the principle that there is to be a capital gains tax—and I am not anticipating the conclusions of the committee, but even the briefs themselves seem to involve this matter of Oriental resignation to it—the issue seems to be what type of capital gains tax we should have. I think we should alert ourselves to the possible conclusions, that this committee looks seriously upon the problem, not the plight of the farmer or the fruit grower, but to the fairness of his treatment; and I, for one, strongly support this.

The Chairman: You mean the fairness of the results, if we apply the White Paper proposals?

Senator Phillips: Yes, I sort of expressed myself elliptically, but the fairness, as you say, Mr. Chairman, of the result; and I would like to plant in the minds of my fellow senators the seed for the development in our thinking that in due course we should come up with a recommendation of special treatment, once we have the category of capital gains, applicable to those who, after all, in co-operation with mother earth and that sort of thing, give us our sustenance. I think they deserve special and fair treatment.

The Chairman: Mr. Peill, you have heard the discussion. I take it you would approve of that concept?

Mr. Peill: Yes, but it is very hard to speak for every fruit grower in reply to this. I do not believe the fruit growers expect just special status *per se*. If the fruit-growing industry turns out to be very profitable in the next few years, I believe that every fruit grower will be willing to pay his fair share.

The Chairman: No, we are not talking about a fair share of tax, but we are talking about the application of the proposed capital gains tax.

Mr. Peill: Right. This ties into it. If capital gain and speculative gain is defined it certainly would help.

The seven points made at the end of our brief endeavour to achieve a similar aim in a more indirect way by accounting for some of the problems that might arise.

The Chairman: It would assist in the matter that you raised with reference to the correlation of estate tax.

Mr. Peill: Right.

The Chairman: It would be removed effectively.

Mr. Peill: Yes.

Senator Welch: Put in simple language, it is indicated in the brief that the farmer lives with no insurance or pension in the hope that one day he will sell the farm and get his retirement money.

If he works on the farm all his life, builds it up with a herd or an orchard then sells it, he finds that about 50 per cent goes for taxes and he still has not enough money on which to retire. That is why I think the capital gains should be reduced or taken out of this White Paper as it applies to the farmer.

The Chairman: It would go towards remedying that situation, yes.

Mr. Gervason: I would like to speak not just for the fruit growers, but for all farmers. They are interested in this problem of an equitable system, however it is formed, wether with or without capital gains. However, we recognize that by the nature of farming considerable investments have to be

made in land as a producing, not speculative, asset.

In this regard farmers in our part of the country in recent years have been buying and selling pieces of land in an effort to make an economic unit of their individual farm. If selling a portion of a farm makes economic sense, then in our view it should not be taxed as a capital gain, because it was not purchased for speculative holding.

However, if an orchard farmer disposes of a marshland portion of his farm because he is going to grow tobacco and plant orchards as this is the most economic thing he can do, he should dispose of some of the land and move into something else. If he has to buy other land of another category or nearer his base of operation, that is fine. This is what farmers are going to do and this is what they have been doing. It has led to great improvement in the economic basis of the farmer in Nova Scotia.

The Chairman: Several of the points inherent in Senator Phillips' remarks would meet that situation. One was that the disposition of a farm by an individual farmer as a farm in use would not attract capital gains tax. That would deal with part of the situation to which you refer.

Mr. Gervason: Yes.

The Chairman: It would also be of value if capital gains tax were defined and an exception included to deal with the situation of a sale which represents the shedding of a portion of a producing asset which is not required required for purposes of production.

Mr. Gervason: Certainly, we would have no objection. If a piece of marshland were sold for industrial development it should be taxed, but if it were merely passed over to another farmer raising livestock who happened to need that type of land, then there should be no tax on the transfer.

The Chairman: Yes. That was your thinking, Senator Phillips?

Senator Phillips (Rigaud): Yes, we have to get down to the really active farmer.

The Chairman: And the problem raised by Senator Welch of the farmer getting to retirement age. No one has found any way of halting that process. Then the farmer could expect more out of the property on which he has spent his lifetime to provide for his retirement.

Mr. Peill: The point is made in our brief that as inflation progresses the capital tax liability would increase under the present proposals.

This could mean that after 30 years a farm property accumulates a sizable tax liability. Before granting a loan a bank or mortgage company would have to consider the tax liability, because only the net amount would remain as security on a forced sale.

This is a point which I do not think is given very much attention at the present time. However, if I had capital gains of $40,000 carried along over 30 years I could never get a mortgage up to the normal 70 per cent. Even the provincial loan agencies such as our Farm Loan Board would have to consider this. When a forced sale takes place the tax liability has to be paid.

This would be an ever-increasing process and after two generations the son would not know whether he could afford to sell. What will be the result if something happens to the operator of the farm? This farming business is tied strictly to the owner-operator. If he is injured he can only sell, because the revenues are not high enough to hire a farm manager in addition to maintaining his family.

The Chairman: You are referring to the possibility of a capital gains tax coming into force without the exceptions that we have been discussing. Then a farmer seeking a loan on his property would find a deduction from the value of an amount which the proposed lender would calculate as being the increment, inflation or otherwise, that might occur in that property during the period that the loan is outstanding. The liability which that would create for capital gains tax in the event of a sale of the property would be considered.

I would assume, even if the mortgagee had to take possession and make a sale, capital gains tax would still apply.

This is the element you are raising now, that if we go to the root of it and are able to carry the day on the basis we have been discussing, this other problem does not arise.

Mr. Peill: No; if an approach could be found along these lines many of these problems would be eliminated.

Senator Phillips (Rigaud): I am not very much impressed with the argument that the capital gains tax is related to inflation in any way.

First of all, you pay inflated dollars not new, in relation to the old value. The real issue with the capital gains tax is that it relates itself to valuation on valuation day, irrespective of problems of inflation, deflation, and so on. It is what a willing buyer will pay to a willing seller under ordinary circumstances. In my opinion the subject of inflation has nothing to do fundamentally with the application of a capital gains tax. But that is en passant, because we are not dealing with that subject here. We will be dealing with it in committee.

I should like to make one further observation in respect of my support for exemption for natural growers on the soil bona fide. In my opinion, there is no such thing as a fair market value between a willing buyer and a willing seller, and treating them equitably. By way of example, if I own a share of a stock listed on the Canadian Exchange, I have a world market for the sale of my commodity; a price is established because there are a tremendous number of buyers and sellers. Whereas a fruit grower in Kemptville, or a farmer in Rosetown has not got that market, and to speak legitimately of a willing buyer and willing seller in a restricted regional area stretches the whole concept, in my opinion, to absurdity as to the proper valuation. If I have a farm in southern Saskatchewan there are very few people to whom I can go. But if I have a share in International Nickel, there are a lot of people bidding for that share and it has an increased value. This just does not make sense to me.

The Chairman: You say there is a limitation on this theory of the willing seller and the willing buyer.

Senator Phillips (Rigaud): It does not apply.

The Chairman: That character is even more fictional than the reasonable man in law.

Senator Phillips (Rigaud): That is right. I have stated my case as further support. I have dealt with the basic points and why I think farmers, fruit growers and the like are entitled, in my opinion, to complete exemption and secondly, why it is fictional to suggest, as the White Paper suggests, that you can seriously expect a true valuation on valuation day.

The Chairman: Or that there will not be a contest ten or fifteen years from now.

Senator Phillips (Rigaud): Yes.

The Chairman: The administration changes, the outlook of administration changes, the idea of values changes; fifteen years from now people's ideas are coloured by what has gone on in the meantime, and they are not able to put themselves back to that date. It is therefore essential if there is to be a valuation date that it be locked in.

Senator Connolly (Ottawa West): I did not hear the earlier part of the discussion, so perhaps what I say will be irrelevant. Listening to what the witness said, it seemed to me that his position could be adversely affected in these circumstances. Let us say his farm is valued on valuation day at a certain figure; it remains in the family, and ten years later they decide they want some money which they can raise only by way of a mortgage, for an expansion or a development of some kind. I would think that the equity in the farm would be looked at very carefully by the mortgagee to see what tax liability had accrued between valuation day and the day the mortgage was to be given, to say nothing of the tax liability that might accrue during the period of the mortgage.

Mr. Peill: This was a new thought, the tax liability which will accrue, which the chairman brought it up, during the run of the mortgage. We were thinking primarily about the tax liability from v-day to that date.

Senator Connolly (Ottawa West): And that would increase the value of the equity.

Mr. Peill: It is true that it will even carry on, because if the mortgage goes for twenty years the lender will have to consider this period too, because he wants to be secured up to the last payment.

The Chairman: Except, Senator Connolly, to the extent Senator Phillips has pursued this question, which Senator Welch and Senator Aseltine mentioned, this would provide a solution, so you would not have to give any concern to the question of the increases in value by reason of inflation or otherwise; that is, if we created an exemption; that is, a genuine farm which is in use.

Senator Aseltine: In actual operation.

The Chairman: Yes, on the sale of that farm in use, not a sale for a different use, the capital gains tax should not apply. A farmer who has built his retirement savings plan into his property, who has not created a plan in which he has contributed so much money a

year but has put it into the farm expecting that that farm will produce his retirement savings money when he has to retire, only to have it eroded, presents serious problems.

Senator Aseltine: He might almost have to go on relief when he retires after he is 65 years of age.

The Chairman: It does not strike me that that kind of position can be justified. I am inclined to the view that Senator Phillips' has at present, and I would suspect Senator Welch too.

Senator Isnor: I would like to go on record as saying that I too approve of the policy and views outlined by Senator Phillips. The witness made a statement about 20 acres. Is that the average?

Mr. Peill: It is always very difficult to deal in averages, because one might give a wrong figure. Right now the average acreage is 14 acres in the Annapolis Valley. But smallholdings are rapidly disappearing, and we see more and more blocks, economical blocks, of 20, 30 and 40 acres being planted within one year.

Senator Isnor: That is what I thought, that it was larger than 20. Are there many sales of orchards in the Annapolis Valley?

Mr. Peill: Right now orchard sales are more and more difficult, because orchards still contain older varieties that used to be grown for the British market, varieties that even processing plants do not want today, because they are hard to process, they do not yield enough. I would say that the price paid for old orchards is relatively low.

Senator Isnor: That has been corrected, has it not, in regard to the number of types of apples for sale?

Mr. Peill: Maybe we are planting too much, but there are a lot of young plantings; people are trying to correct this by eliminating older orchards and setting out young, new varieties. They have committed themselves to considerable capital investment.

Senator Isnor: Are many mortgages being taken out in respect of orchards in the Annapolis Valley?

Mr. Peill: We are very fortunate in that the Nova Scotia Farm Loan Board has supported the farming industry, particularly those who show promising signs of creating economic units. That applies in all phases of agriculture, fruit growing included. It is extremely difficult to get money from the banks; land is still not considered a good collateral for long-range credit. We have the Farm Improvement Loan Act under which we can borrow money up to $15,000 per individual, and this is as far as it goes. To take mortgages from conventional mortgage companies is out of the question because the rates are too high.

The Chairman: Is there any other point, Mr. Peill, which you would like to talk about?

Mr. Peill: There is one point which we mentioned in summing up our brief and this is the municipal taxation which is a tax level, not at the ability to pay, but on capital investment. If the tax structure is going to be changed, a close look should be given to these factors. This is an operating expense now which has nothing to do with whether the operation was successful or not.

A survey made by the Canadian Department of Agriculture of seven fruit growing farmers showed that the municipal tax paid amounted to 5.5 per cent of the net farm income, or 2.2 per cent of the gross farm income. I suggest that this is a sizable sum.

The Chairman: The only way it strikes me, subject to what the committee might think, is that municipal taxes as such are a separate and distinct problem from what we are looking at. From the point of view of the farmer and the fruit grower, whom you are representing, they are part of his cost and he has to find the money to pay for them. Certainly he would be in a better position if some of the ideas we expressed this morning were passed into law. He will be in a better position if the individual tax rates proposed in the White Paper for a lower base of income are implemented, but I do not see how we can directly deal with the problem of municipal taxes. This is not under our jurisdiction at all.

Mr. Peill: I realize that, but it was put into the brief to be taken into account as part of the whole tax burden, and if the suggestion that an active farm be exempted from capital tax gains comes through I would think this is a minor matter.

The Chairman: I would think that a farmer, carrying on a fruit growing business, in preparing his income tax return, would include the municipal tax as part of his operating expenses and he would get a reduction in that sense.

Senator Phillips (Rigaud): That is the point I was going to make, that the municipal tax is

an outlay related to the income earning process of the grower.

The Chairman: Is there anything else you wish to add?

Senator Urquhart: There used to be a subsidy in effect in Nova Scotia for a farmer who transferred from the old type variety of apples by cutting the trees down and planting a new orchard. He was given so much per tree. Does that still prevail?

Mr. Peill: You may correct me if I am wrong, but as far as I know there is no subsidy at the present time with the exception of land clearing. The provincial government will then pay a subsidy for the removal of trees to the extent of half the machine costs.

Senator Urquhart: It used to be $4 a tree.

Mr. Peill: That is not in existence any more.

The Chairman: We have enjoyed your presentation and think that there is real merit in it. I want to thank you very much for coming here today.

Mr. Peill: There were other points with regard to capital gains coming into effect, which should be discussed at further length, but knowing the thinking of this committee I do not feel it is necessary to bring them up at this time.

The Chairman: It is in the brief, gentlemen, and we have read it.

The committee adjourned until 2:15 p.m.

Upon resuming at 2:15 p.m.

The Clerk of the Committee: Honourable senators, in the absence of the chairman is it your pleasure to elect an acting chairman?

Senator Molson, I move that Senator Everett be acting chairman.

Hon. Senators: Agreed.

Senator Douglas D. Everett (*Acting Chairman*) in the Chair.

The Acting Chairman: Honourable senators, we have a brief from Molson Industries Limited. It is apparently not the intention of that company to make a personal appearance before the committee. Could I have a motion that this brief be printed and attached to today's proceedings?

Senator Haig: Mr. Chairman, that is not on the agenda for today.

The Clerk of the Committee: They are not appearing, sir, so it will not be on the agenda.

Senator Haig: Why should we agree to print it if we have not seen it?

The Acting Chairman: There seems to be some difference of opinion. With your agreement I suggest that the brief be distributed to honourable senators, as suggested by Senator Haig, and left over to the next meeting in order to allow honourable senators time to read it.

Honourable senators, we have an appearance from the Canadian Medical Association. You have their brief before you. Will the officers who are going to present the brief of that association please come forward—Dr. Matthews, Dr. Gosse, Dr. Sylvestre, Dr. Harnick and Mr. Freamo.

Dr. Matthews, do you have an opening statement?

Dr. R. M. Matthews, President, Canadian Medical Association: Mr. Chairman, honourable senators, I do not propose to take much time in introducing this brief. You have had a copy of it. It is in three parts. There is a summary of our recommendations. There is the brief proper, where we endeavour to persuade you of the fairness of our position, and there is an appendix where we express a particular concern as to the tax position of expenses incurred in continuing education. This appendix is presented in collaboration with certain other organizations which share a common concern. Among them is the Association of Canadian Medical Colleges and The Canadian Association for Continuing Medical Education, who are represented by Dr. Robert Jackson. There is the College of Family Physicians in Canada, represented here by Dr. Rice; the Royal College of Physicians and Surgeons of Canada, represented by Dr. Dixon, President, and by Dr. Salter, Dr. Graham and Dr. Turcot who will arrive later. There are other people who are more knowledgeable than I am in the technical parts of this brief on the proposals for tax reform.

There is just one area which I would like to comment on. We mentioned in several places the mobility of doctors and the effect of excessive taxation on our problem of keeping them in Canada. This is a matter that we bring up with considerable regret. The Canadian Medical Association does not hold any brief for doctors emigrating to the United States or other places. At the same time, we do not feel it would be proper to withhold

from you our real concern that disparities in economic opportunity cannot be ignored in relation to the shortages of medical personnel which we experience in Canada and which is experienced in an equal amount in the United States. The drawing power of the States on all academic disciplines has been obvious to us for a long time. In 1965 an operation retrieval was commenced under the auspices of the Association of Universities and Colleges of Canada. There was little attempt being made specifically to the medical graduates until 1967, when the associates of the Canadian Medical College embarked on their own version of an operation retrieval directed to the graduates of Canadian medical schools who were interning or undergoing residence training in the United States.

This is a project which the Canadian Medical Association heartily approves. We feel that any effort in this direction can only be commended. We have a real shortage of medical personnel, and there is a drain of doctors. Whether they should go or not we feel is not a proper consideration. In point of fact, they do leave the United States.

Senator Connolly (Ottawa West): How successful has the retrieval been?

Dr. Matthews: We do not know. It is too early, since it began in 1967. It is a long-term project. They are being sent lots of literature, and the hospitals are being visited by teams from the Association of Medical Colleges. The personnel are being talked to in hospitals where they are interning. They have had a favourable reception, but we have not the statistics to give you an answer to that question. When the drain started we know there were about 900 graduates of Canadian medical schools in the United States at any one time. The latest figure was about 700. Whether this is due to this operation retrieval or other factors, such as the war in Viet Nam, we cannot answer. We do know, and this is our concern, that anything that does increase the discrepency in disposable income between doctors in Canada and doctors in the United States is bound to jeopardise to some extent anyway—it is an intangible business—our efforts to attract them back.

Senator Connolly (Ottawa West): Have many returned?

Dr. Matthews: They are coming back all the time.

Senator Connolly (Ottawa West): I know that you do not have the statistics, but you do have evidence that the return flow is working.

Dr. Matthews: There is a return flow, but it is not properly documented.

Senator Connolly (Ottawa West): If there is going to be some further consideration on this point, I wonder if the spokesman would also consider the question of inflow from other countries to Canada to supplement the existing supply of doctors in Canada?

Dr. Matthews: It is obvious that there is an outflow and an inflow. There are two sides to the question, the ones you lose or the ones you cannot attract. Again the economic opportunities are going to make a difference, whether to attract them here or keep them here.

That is the end of my statement. I would like, if I may indulge upon you, to have Mr. Freamo run through some of the other parts of our brief rather quickly.

The Acting Chairman: Before we do, are there any other questions with regard to Dr. Matthews' statement?

Senator Carter: I should like to follow on the question Senator Connolly (Ottawa West) asked earlier. Are the doctors who come to Canada from other countries attracted here for the same reasons you say Canadian doctors are attracted to the United States? Or are there other factors involved?

Dr. Matthews: There are a good many factors involved, sir. There are the conditions under which they are practising in their own country; there are the opportunities here for practice—the economic opportunities; there are also opportunities in other fields, such as research and teaching; and there are the facilities with which they have to work. At any one time it is the balance among these factors in the other countries of the world, in Canada and in the United States. I cannot be more specific than that.

Senator Carter: A doctor from Europe or from the United Kingdom who wants to leave could go to Australia or to the United States but he comes to Canada instead. Is that because it is easier for him to get settled in Canada than it is for him to get settled in the United States or Australia? I ask that because some of them come here first and then leave afterwards.

Dr. Matthews: Some of them come here and remain here for several years in a posi-

tion where they are still mobile and are still looking for other opportunities. It may be a permanent move or it may be a temporary move in which, before the time they get their roots down, they are still looking around.

Senator Carter: What I am getting at is whether there are any special factors in Canada that bring foreign doctors here as an indirect route to the United States. They don't go directly to the United States. They come here first and then go to the United States.

Mr. B. E. Freamo, Acting General Secretary, Canadian Medical Association: There are a number of factors involved, senator. First of all six of our provinces in Canada have a basis of reciprocity with the British Isles by which doctors can come directly from the British Isles and practise in those provinces without any further period of training. Secondly, a great number of doctors from Europe come to the province of Quebec if their mother language is French, because that is a natural place for them to come to. Thirdly, there are quotas on many of the countries for direct entry into the United States. So there are a number of reasons why they come to Canada as opposed to going directly to the United States.

Our concern is that the number of doctors coming to Canada is going to drop. At the moment it is a very large number. Last year there were about 1,300 doctors who came into Canada from other countries. That is more than the number of doctors we actually graduated in Canada itself last year. Currently we need this number of additional doctors to provide the services that are required by Canadians, and anything that affects this flow, that would decrease it to 800 or 900 would have an adverse effect on the medical services that the profession can offer, and, of course, anything that increases our immigration to the United States either of native Canadians or of doctors who come to Canada from foreign countries again affects our position.

Senator Beaubien: Is it difficult for Canadian doctors going to the United States to get into the United States?

Mr. Freamo: Not at all.

Senator Beaubien: They can get in easily? There is no big problem, in other words.

Dr. Matthews: Some states have reciprocity with Canadian licensing. In some states they have to try American state boards, but by and large a Canadian-trained graduate can get into the United States without difficulty.

Dr. C. L. Gosse, Canadian Medical Association: There is one problem in the United States that works to our advantage at the moment. The draft law down there keeps some of our doctors home, and we are fearful that when the war in Viet Nam ends the draft law will no longer be a deterrent. Actually, at the moment, it is a very real deterrent. Also, a lot of doctors return home before they are subject to the draft in the United States. They return a month or so before they would be subject to the draft.

Senator Beaubien: What is the cut-off point for the draft in the United States?

Dr. Gosse: For professional people it is when they are quite old. They can be drafted up to a greater age than the ordinary non-professional population.

Senator Molson: What is the effect of the new North American quota which has been a deterrent to movement of business executives and which recently is being modified, I believe? Has that been a deterrent to the medical profession?

Dr. Gosse: It does not affect it.

Senator Molson: There is no delay involved at all?

Mr. Freamo: We have seen no barrier at all to a doctor who wants to go to the United States and has a position down there waiting for him.

Dr. Matthews: Actually, the United States medical people are advertising in our journals all the time with openings and salaries that we do not match. The one thing that does keep them here is the belief that we all share that Canada has a future second to no country in the world.

Senator Benidickson: In reading the brief I see that you indicate a concern with respect to the inflow of immigrant positions. I have a clipping which I took some time ago from the Winnipeg newspaper, which made my hair stand on end. It outlined the roadblocks which were put by the profession in front of a graduate doctor from a European country.

It has been stated that you have reciprocity with respect to Great Britain. Having regard to the public need for doctors, this astonished me. There was a case recited on how difficult it was for a Czechoslovakian, Hungarian, or

applicant of other nationality and what he had to go through before he was accepted by the profession.

In view of what I have said I was a little surprised to see concern expressed in your brief with regard to immigrant doctors.

Dr. Gosse: It is only fair to say that medical societies and schools across Canada have tried to set standards that Canadians would wish for and accept.

We have knowledge of what goes on in many universities of the world, the kind of course given and the general calibre of their qualifications when they finish. We have those universities pretty well rated and our ratings are not much different from those of the United States, England and other countries that we know produce good medical doctors.

When these people apply we have to assess their qualifications and try to decide either by examination or an extra year of internship where we can observe them, whether they are qualified to the standard of practice we have set for the Canadian people.

This has gone on in a number of instances. There are certain countries where these people go to medical schools and practically never see a patient all the time they are there. This has been the case in some of the instances where people have been barred from entering.

Senator Benidickson: I was not referring to complete barring but, as I recall, this individual was interviewed by a press reporter who followed his career. It took him three years to go through the various roadblocks that were presented to him in Manitoba.

Dr. Matthews: It is difficult to discuss individual cases. One thousand three hundred came in last year, more than the output of Canadian medical colleges.

The licensing bodies do take the attitude that has been pointed out, that their responsibility to the public is to set standards. They do not know why the standards should be lower for people from outside the country than for our own students.

I am sure that there are individual cases on which one could argue the point. By and large it is a question of the standards of education and medical training in other countries and whether they are comparable to ours.

Senator Isnor: From what country did the majority of the 1,300 come?

Mr. Freamo: The largest single country will be Great Britain, then the western European countries will have the next largest block. Beyond that it is all over the world.

The Acting Chairman: Senator Isnor, would you like the gentlemen to file a breakdown of the 1,300?

Senator Isnor: No, I do not know whether it is that important.

Senator Connolly (Ottawa West): With reference to the brain drain, do you find any significant exodus to developing countries and is it a long term matter with doctors who go there?

Dr. Robert Salter, The Royal College of Physicians and Surgeons of Canada: Mr. Chairman, honourable senators: The brain drain to developing countries is really not our major problem. There is very great concern with regard to the United States. Many doctors leave shortly after graduation, before taking post-graduate training, for perhaps a year or two. We think this is good and makes an individual a more competent doctor. These men, by and large, come back to Canada and many of them become our most distinguished physicians and surgeons and subsequently take university positions.

Other men take leave of absence from their own position for perhaps three or six months and go out under the auspices of CANACESO or some other organization to help the developing countries. These people do this at considerable personal sacrifice.

We are concerned from the standpoint of manpower in this country with those individuals whose education has been paid for to a large extent by the Canadian Government. It costs this country a great deal to graduate a medical doctor then lose him to the United States.

Our Canadian medical graduates are looked on very favourably in the United States. There are certain aspects of our undergraduate teaching programs in Canada that are better than those in the United States. The American programs prefer to have Canadian graduates.

If a graduate decides he is going to live in the United States because of financial benefits, or for whatever reason, and takes his training and stays there, we have lost a great investment in this country. A replacement from Czechoslovakia, Ireland or Great Britain is really not the answer.

Mr. Freamo: I would like to point out two items in the recommendations of our brief that are unlikely to be found in other briefs. They are peculiar to the medical profession, or at least to professional persons.

Perhaps you will not receive too many briefs that suggest to you that we are not unhappy to see a capital gains tax introduced. In our brief we suggest that while some doctors are opposed to the concept of capital gains, most of the profession seems to be in favour of the introduction of a capital gains tax. However, it is also true that most of them feel that the introduction of a capital gains tax would reduce the amount of taxation they are already bearing, as their income is primarily from fees and fully taxed under our present system. It had been their thought that with the introduction of capital gains tax this would have eased the situation a little for the type of taxpayers that doctors basically are.

We were somewhat unhappy to find that that is not the case and the White Paper proposes an actual increase of tax for current, regular income, then the addition of capital gains tax. Therefore we have some comments pro and con capital gains.

We feel very strongly that a tax should not be paid on paper profits, and that if a capital gains tax is introduced it should not be out of line with that of our neighbour to the south, and that perhaps we should have a good look at the rates of tax proposed so that the Canadian taxpayer is again not unfairly differentiated against in comparison with his American neighbour.

The other item or particular concern to the profession has to do with the basis of accounting, the cash or accrual method of reporting income. We have some very specific thoughts on that subject, such as the taxation on investment income by non-profit associations, which we feel is just transferring money from one pocket to another without achieving a great deal in the process.

We have some recommendations to make to you with regard to registered retirement savings plans. We are very concerned about this, as doctors use this method of investment to provide for their retirement income. The association, through a subsidiary corporation, actually runs a registered retirement savings plan for its doctor members.

Senator Connolly (Ottawa West): I am sorry to interrupt, but are you going to enlarge upon some of these categories you are discussing?

Mr. Freamo: We felt you might have questions to ask on these.

Senator Connolly (Ottawa West): Would you do that now.

Mr. Freamo: Certainly.

The Acting Chairman: We could hear Mr. Freamo's statement and then go through it recommendation by recommendation, if that is agreeable to honourable senators. That is, is he is not going to deal with the specific recommendations in his statement.

Honourable Senators: Agreed.

Mr. Freamo: Mr. Chairman, the other recommendation that is of considerable interest to the profession and which is contained in our brief has to do with conventions and our need for them. These have a legitimate place in the Canadian community, and our request is that the legitimate expenses of attending these conventions be recognized.

Sir, if you are going through the recommendations one by one I think I could end my statement now, and the questions asked would elicit additional information on each of the subjects.

The Acting Chairman: Are there any other statements to be made.

Mr. Freamo: No.

The Acting Chairman: The first recommendation is as follows:

> We recommend that the proposed income tax rate structure be re-examined in conjunction with the revenue yields projected by the government, with a view to alleviating the income tax burden on middle and upper-middle income taxpayers.

Have you any comments to make on that?

Mr. Freamo: I mention briefly the concern of the profession. Our attitude generally towards capital gains was predicated on the fact that we felt this would allow a reduction in tax on the forms of income. The White Paper proposals do not do this, but, in fact, increase the tax that would be paid except at the very upper end of the tax scale. We find it difficult to reconcile this proposal of the Government with published studies by the Government of Ontario and other bodies that the yield from the taxation rates set out will

be considerably higher than that proposed in the White Paper. We feel that if this is so, a good re-examination of the position of the middle and upper-middle taxpayer needs be undertaken and that we should not just look at this group of people as a gold mine to tax and tax and tax. At some point it becomes an oppressive rate of tax which applies to this particular group of people.

The Acting Chairman: In that connection, Mr. Freamo, perhaps you could read the paragraph on page 5, and we shall include the table.

Mr. Freamo: The following table illustrates the disparities between the American and Canadian taxpayer at various levels of income which a doctor could be expected to earn:

	Canadian Federal & Ontario	U.S. Federal & State Income Taxes Resident of:	
Net Income	Income Taxes	New York	Ohio
$20,000	$ 5,262	$3,002	$2,480
25,000	7,434	4,274	3,488
40,000	14,711	9,819	8,039

It might be useful to the committee to emphasize these disparities by the use of a hypothetical situation. Let us consider the status of an experienced doctor in Canada who earns $40,000 per year and emigrates to the State of Ohio at age 40. If we assume that he earns the same income in the United States and subsequently retires at age 65, he will have paid an aggregate of $166,800 less in income taxes than he would have paid in Canada over the same period. The difference in after-tax accumulation assumes even more astronomical proportions if we take into consideration that a doctor in the United States earns more than his counterpart in Canada.

On the average he does earn about 25 per cent to 30 per cent more than the doctor in Canada.

Senator Benidickson: I do not understand your item (e) where you say:

> The exchange difference between the Canadian and U.S. dollar has been taken into consideration.

What effect has that when you compare the total taxes paid on certain income by a resident of Ontario and a resident of New York or Ohio?

Mr. Freamo: Actually, sir, the exchange difference has been taken into consideration in computing the $166,000. There is a seven per cent difference between the United States and the Canadian dollar, so you can deduct that amount of money if you consider the $2 at a par.

Senator Benidickson: I have seen the figure and you are familiar with it probably, because you make reference to the fact that some of your calculations have come from the latest report from the Department of National Revenue, which I think refers to earnings in 1967. Do you recall what the average taxable income of the medical profession was at that time as reported in 1967?

Mr. Freamo: In 1967 it was in the order of $26,000.

The Acting Chairman: Are there any other questions on this recommendation?

Senator Isnor: I was rather surprised at the reference made about capital gains. I recall that in the East a large amount is invested by the medical profession in buildings to house doctors. I think it is a good move. Do you propose that a capital gains tax should be used in that connection?

Mr. Freamo: I think we are trying to present a consensus, and the view of the profession generally is that most of their income comes from fully taxed dollars. It is professional revenue which is reported to the Income Tax Deparment and on which full tax is paid. They feel that if there are other types of income which are not taxed then they, as taxpayers, are at a disadvantage in comparison wih other taxpayers. As I said earlier, it was certainly their hope that the introduction of the broadening of the tax base would allow a reduction in the rate of tax they currently pay. It is still their hope that this might result in that, on the basis of what we would consider a proper analysis of our tax system relative to income with some special attention paid to this particular group.

Senator Isnor: I raise that question, Mr. Chairman, because I think this is the first brief we have had that favours capital gains.

Senator Benidickson: No, senator. Others have suggested that the capital gains be at a smaller figure or a smaller amount.

The Acting Chairman: We have had a number of briefs, Senator Isnor, that have indicated the inevitability of capital gains. But almost every brief has disagreed with the methods proposed in the White Paper.

Senator Isnor: Yes, I think that is a more accurate statement.

Senator Molson: May I ask if the medical profession will accept or favour the whole policy of integration in this regard?

The Acting Chairman: Are you conversant with integration?

Mr. Freamo: A buck is a buck, yes. I think that is it basically.

Senator Connolly (Ottawa West): More particularly, the piling of capital gains on top of earned income as part of the income.

Senator Molson: At income rates.

Senator Connolly (Ottawa West): At income rates, yes.

Mr. Freamo: No, I don't think I had thought of it that way.

The Acting Chairman: Perhaps we should define our terms. I think what Senator Molson is referring to is the fact that the capital gains tax is, in effect, an additional income tax and that, if a gain is realized, it is at the top marginal rate that the taxpayer is paying and that, if a loss is suffered, it is a deduction and therefore at a lower marginal rate. Would you care to comment on that?

Mr. Freamo: Well, I would prefer to see it set up more specifically before commenting in detail on it. Our concern is first of all that we believe there should be a broadening of the tax base to take in other forms of income. This is our first concern, secondly, we feel that the rate of tax to apply to either earned income or to capital gains—however you would put it—has to be reasonable and has to bear some relationship to what applies in the United States. If we have a capital gains tax of 50 per cent and the United States has one of 25 per cent, then I think Canadians are at a disadvantage. To reiterate, we believe in widening the base and we think that the applicable rate should be considerably lower than proposed.

Senator Molson: Would it be your idea that perhaps a better form of capital gains tax might exist in a capital gains tax *per se* at some rate not incorporating the capital gain with the individual's income?

Mr. Freamo: That is right.

Senator Molson: I should perhaps tell you that this committee has heard a fair amount of discussion about that point, and various percentage rates have been suggested, from 15 per cent to 25 per cent, for example, but the suggestion was that a capital gain should not be added to the individual's income and then taxed as income but should be maintained separately.

Mr. Freamo: A complete separation would be preferable in our opinion.

The Acting Chairman: Is that the opinion of the association?

Dr. Gosse: Yes.

Mr. Freamo: Yes.

Senator Aseltine: If most doctors make this much money, they would be paying a 50 per cent rate on the capital gains tax.

Mr. Freamo: Yes, that is true.

Senator Aseltine: If you added it on to their other income they would almost certainly be paying a capital gains tax of 50 per cent.

The Acting Chairman: Honourable senators, I think we have dealt sufficiently with the capital gains situation.

Senator Connolly (Ottawa West): Except for one point. If a government—and I care not what government it may be—finds a new field in which it can tax, let nobody think that the government will not exploit the old field and the new field as well to the limit ultimately.

Dr. Gosse: With respect to capital gains being taxed, we are concerned that there is no provision in many cases for a capital loss to be deducted. Moreover, we feel that capital gains tax should be paid only when the gain is actually realized rather than waiting for the five year valuation, because in that situation if you have stocks you may have to sell them at a loss in order to get the money to pay off the tax. That is of some concern to us.

The Acting Chairman: If honourable senators are finished with that point, we could move on to the recommendation 3, referring to the tax on principal residences.

Dr. Gosse: We feel that the White Paper seems to have in mind that taxes on residences would not really be a great hardship on anybody and that in allowing the additional $1,000 a year plus $150 for expenses that would for the majority of Canadians almost neutralize any increase in that particular type of residence. However, if this tax is done on the basis that the White Paper is proposing an equitable type of taxation, then we feel that people in the higher income groups are going to be hit quite unfairly in this respect. Doctors who buy houses worth perhaps $30,000 or more and then sell their houses are going to find that the $1,000 a year is probably not going to eat up that appreciation nearly to the extent that a $10,000 or $15,000 or $20,000 house might.

Senator Benidickson: You mean appreciation due to inflation itself?

Dr. Gosse: Yes, appreciation due to inflation itself, right. We thought therefore that, instead of a flat rate, perhaps some percentage should be applied. If on the basis of a $15,000 home we are allowing $1,000 a year, then, when it is sold, that situation perhaps neutralizes itself after a period of time. Perhaps 4 per cent or 5 per cent of the value of the average home in Canada is a percentage that might normally be expected to apply. We feel such a percentage would apply to all types of houses and would be fairer than a figure that applies only to certain kinds of houses.

The Acting Chairman: May I interrupt you there? I understood, though, that this recommendation was part of a group of recommendations that you would make, but that you would rather there be no capital gains tax on the sale of the principal residence. This is merely an alternative.

Dr. Gosse: I was getting around to that, yes. This is an alternative. You are quite right. Our prime objection is to the tax itself. If, however, the minister feels that he must put a capital gains tax on the principal residence, then we felt on recommendation 3(b) that it might be allowed on a percentage basis.

Senator Connolly (Ottawa West): The members of the medical profession have been pretty well described as people who are located in a given area. They buy a home after their practice has been established and they usually settle down there and stay there perhaps until their family has grown up. They are there for a great many years and a good deal of their capital accumulation is sometimes represented mainly in that home.

Now, because of the peculiar character of your profession and your association with the community in which the practitioner settles, do you think that it is equitable to say that that home, which perhaps would also be the doctor's office, might be exempt from capital gains for the reasons that I have given which are peculiar to your profession?

Dr. Gosse: Well, to a certain extent, sir, that is a correct assumption, but doctors today are moving far more often than they ever did before. It is this particular group of moving doctors with whom we are more concerned. For example, today young doctors upon graduating go out to practise for three or four years in one place and then, quite often, they decide they want to take postgraduate work. So they go into a town, buy a home that naturally is one of the better homes there, and which to have an office in it it must be big, and when they leave they sell, perhaps by forced sale. Perhaps no one is coming in to take their place. They get comparatively less for their home.

We give an example on page 8 of the brief where a home was acquired by a taxpayer at a cost of $45,000 and its fair market value on valuation day was $35,000. This is not the example I was thinking of but we say:

> A taxpayer residing in an area where real estate values are depressed on 'valuation day' could later realize a taxable capital gain which would actually include a recovery of his original cost. For example, suppose a taxpayer's principal residence was acquired by him at a cost of $45,000, that its fair market value on 'valuation day' was $35,000, and that he sold it five years later for $50,000. The amount included in his taxable income would be:

Proceeds of Sale		$50,000
Valuation on 'Valuation Day'	$35,000	
Total of Proposed Allowances—5 × $1,150	5,750	40,750
Taxable Capital Gain		$ 9,250

> Although the taxpayer's actual gain is only $5,000, which would normally have been reduced to nil by the annual allow-

ances, he is rendered liable to income tax on $9,250 because of the arbitrary valuation rules.

Mr. Freamo: In answer to Senator Connolly's question, I cannot really see that the position of a doctor in the community is going to be that much different from mine as far as a home is concerned. Most of us, once we are established, stay with the organization that we are with. We invest in a home and it eventually becomes perhaps our largest single investment. However, the typical doctor today will probably own two homes before he moves into the one that he really settles in with his family. I find that doctor's wives, like my own and other wives, are really the people who decide when they are going to buy a house.

As the doctor's practice grows and his expectations become larger, he buys a larger home, because his wife tells him to. Therefore I cannot really see that the position of a physician in the community with regard to his principal residence is different from my own or other members of the community.

Senator Connolly (Ottawa West): Except that the doctor is often the pivot around which the community evolves.

Mr. Freamo: The doctor's house?

Senator Connolly (Ottawa West): Perhaps I should be thinking of the doctor's wife.

Senator Benidickson: Reference is made in this brief to the misfortune and capital loss on a residence should not be deducted. Is that different from a capital loss on some other form of asset?

The Acting Chairman: The White Paper does make the point that because they are permitting a deduction on $1,000 a year, plus another $150 per year, therefore losses on a principal residence should not be deductible.

I think the gentlemen take two positions, that there should be no tax involved in the sale of a principal residence, but if there is a tax on the gain there ought to be a deduction for a loss.

Then we can move to recommendation 4, which concerns the basis of accounting suggested in the White Paper and is found on page 11.

Dr. L. R. Harnick, Finance Committee, Canadian Medical Association: Mr. Chairman, this concerns the present method of cash accrual allowed to a physician under the accounting practices. The existence of the accrual basis, as we see it, is that when a man begins practice the accrual system could cause considerable difficulty for him during the formative period, when his accounts are in the process of collection.

It is obvious to us that attempting to assess inventory such as the work in progress for an accrual system is relatively impossible. Although the introduction of health schemes with prepayment plans has reduced this, there is still the lag of two, three, and depending upon the efficiency of the section one works under, maybe six months before payment is received for work rendered.

A man starting in practice would be hurt significantly.

Moreover, subsequent to his starting in practice and after a man is in practice, after the first year there really is no difference whether it is on an accrual or cash basis. Once the books are rolling on a certain time element is really does not make any difference in the end position. Therefore it creates a hardship without really producing anything in the way of taxes.

The Acting Chairman: All it does is defer taxes, which are eventually paid.

Dr. Harnick: Yes.

Senator Aseltine: How does Medicare affect you people? In Saskatchewan all doctors send their bills to Regina and they are paid right away.

Dr. Harnick: It probably runs about four or five weeks in Ontario. There may be a delay of three months in some areas of the accounts in progress, by virtue of a question raised with reference to a particular account. If the computer breaks down there will be a delay of six months.

The Acting Chairman: On page 10 you refer to the effect of Medicare on the cash or accrual basis. Perhaps you would read the second sentence under "Basis of Accounting."

Dr. Harnick:

> The introduction of medicare, and the regulations of their administering agencies outlawing payment of outdated accounts, reduces the potential for postponing income. Very few doctors have inventories and where no physical inventories are involved, the cash and accrual bases yield the same net result over a period of time, and there is no actual loss of tax revenue.

Senator Connolly (Ottawa West): I would like to press you on one point, if you do not mind. We have had before this committee representatives of other professions, I am thinking particularly of the legal profession, who have opted very strongly for the cash rather than the accrual basis.

There is a distinction between their problem and that of the medical profession. Would you agree that once a bill was rendered to, for instance, the Department of Health in Regina by a doctor for work done under a medical plan, whether it be private or public, it is practically as good as cash in his hands?

Dr. Harnick: I would agree that once a bill is rendered we do not have the problem of attempting to establish the level or value of that account before the work is completed. One of the big problems which occurs in the accrual system is for a man starting in practice, where during the course of writing off his original investment and getting into practice he suddenly finds that he is paying tax on perhaps a great amount of rendered income which he has not yet received.

Senator Connolly (Ottawa West): Taking into account the fact that the taxation year is the calendar year, I do not think you went beyond three months for the time lag. Your tax returns are due at the end of April, but you have to pay quarterly, of course. If the time lag is three months or less the doctor will have had all of his accounts paid by the time he has to make his clients' settlement for the calendar year.

Let me ask this final question. Suppose for the sake of argument that this committee, on the basis of the recommendations made by the legal profession, decided it was wise to recommend that for professional people the tax should be paid on a cash rather than on an accrual basis, would you think that that would carry the endorsation of the medical profession too?

Dr. Harnick: Yes.

Senator Benidickson: In some jurisdictions a doctor is entitled to send a bill for something extra beyond what is paid under the insurance plan. For instance, an insurance plan might pay a percentage of your standard fees but a doctor can see fit to render a bill for the additional 20 per cent to the patient. That is an uncertain collectibility.

Dr. Harnick: Yes.

Dr. Gosse: We say that that involves a great deal more bookkeeping. Most doctors are not that good at bookkeeping. They know how much money they have taken in by looking at the bank statements, but when it comes to working out an accrual system it really requires quite a bit more work. The auditors available in the cities are not often available in the rural areas. For that reason I think it is going to be a hardship on that particular segment of the profession.

Senator Beaubien: And a lot more work.

Dr. Gosse: Yes.

Dr. Harnick: I do not wish to leave the committee with a misapprehension as to the status of physicians in large areas of Canada. There are many physicians who bill their patients and do not receive funds from clients directly. In those instances the same applies as always between a patient and his physician.

Senator Isnor: You are better off today because you receive 85 per cent.

Dr. Gosse: It is 90 or 100 per cent in Ontario. It is 100 per cent in Saskatchewan.

Mr. Freamo: There is a difference between the accounts receivable of a firm and the accounts receivable of a professional person. There is a very big difference if you go down to the bank. If you take your accounts receivable you can borrow money. A professional person cannot borrow money from the bank on his accounts receivable. It is an entirely different category.

The Acting Chairman: Beyond the problem of the receivable there is the working process account. A firm in business is set up to assess its working process account. A professional man really has no accounting services upon which he can accurately determine the working process account. It is pointed out in the brief that in many practices this would create an intolerable expense.

Senator Isnor: What do you mean by that?

The Acting Chairman: I think what they mean, Senator Isnor...

Senator Isnor: What do you mean?

The Acting Chairman: What I mean is that the work they have not completed at the end of a taxation year must be priced to the extent that it has been done, and that amount must be taken into account despite the fact

that they cannot bill a patient until after the work has been completed.

Senator Benidickson: They must finish the job.

Senator Molson: Or finish the patient!

Senator Connolly (Ottawa West): They might not get either.

Senator Molson: There is one difference between this profession and the architects profession, Mr. Chairman, as you may remember. The architects pointed out that it was very difficult for them to collect on work that was only partially completed. I do not know if the doctors would admit that they have the same problem.

The Acting Chairman: I would not want to admit to a doctor halfway through an operation that I had no intention of paying his bill.

You say in your brief:

> There would also be a temptation to use this as an income levelling device.

Could you tell us how this might be done?

Mr. Freamo: No one other than the doctor would have any idea at all what the working process was. He could just think of a figure at the end of each year. Who else could come into an office and say, "You did not have that much working process. You had ten cases of surgery the beginning of January. How much work have you done on these cases?" He is the only person who knows.

Senator Connolly (Ottawa West): I would think, Mr. Chairman, that one of the problems of the medical profession arises from the fact that unlike almost any other it is a scientific job that the medical man knows. Because of the complexities of our tax system he is required also to become an accountant. If he is like the lawyer his natural inclination is to keep as far away from that as possible. This creates a real problem for professions other than perhaps the accounting profession.

Senator Molson: Do not exclude them.

Senator Connolly (Ottawa West): I think the accountants at least can be held accountable.

Senator Aseltine: That is their business.

Senator Connolly (Ottawa West): The simpler it can be made for the profession the better it is for the profession to do the kind of work it is designed to do, and the kind of work that its people are dedicated to do.

Dr. Matthews: That is very true, Mr. Chairman. There are areas in larger centres and in group practice where doctors have achieved a certain sophistication of accounting, and some of them on an accrual basis, but the independent practitioner in a small place finds it very difficult to get the sort of help he needs to keep that sort of accounting book. That is what we are protesting about.

The Acting Chairman: Does that complete your questioning on the particular segment of the brief?

Honourable Senators, Senator Connolly has to leave and he has asked if we would be agreeable to moving forward to recommendation number 12 on page 21 regarding registered retirement savings plans. Is it agreed?

Honourable Senators: Agreed.

Dr. Sylvestre: The Canadian Medical Association takes a position that the retirement savings plan established in 1957 for self-employed people had certain objectives to reach. One of them was to keep a person solvent and self-sufficient throughout his retirement. Arising out of this presumption one finds that while the standard deduction for retirement purposes has remained at $2,500 per year, the cost of living index has reached up to higher proportions in the interval and, proportionately, it would be acceptable to raise the reduction concerning the retirement savings plan. With that in mind we wrote the recommendation that the allowable contribution of $2,500 be increased to $3,500 and that, by the same token, the maximum contribution for salaried taxpayers be increased proportionately.

Now, a second point that we bring up for consideration is that many of our doctors have entered the retirement savings plan at an age where they could not accumulate a great amount to achieve the natural objectives of self-sufficiency and solvency through retirement, and we propose that a provision be made for higher contributions of a deductible nature for these persons who are over the age of 50 and of necessity have not had the same chance that I should have, for example, being younger, of contributing over a longer period of time.

The third proposition we bring up is that the maximum allowable contribution be adjusted periodically to reflect changes in the purchasing power of the dollar in order not to let the phenomenon of the last 13 years to be always taking up the slack or whatever recommendation we make in this respect.

Senator Connolly (Ottawa West): Just on that point, what you are suggesting, I take it, doctor, is that the maximum amount that can be paid into a retirement savings plan in any one year be tied to an index which might escalate perhaps with the cost of living index.

Dr. Sylvestre: Right, sir.

Another point we are bringing forward, sir, is that we find that the proposals in the White Paper concerning the lump sum withdrawals and especially the death benefits accruing to the estate of a person who is a participant in the retirement plan have been construed to so punitive that there would really be no advantage to having a retirement savings plan. Finally, we believe that the restriction of the 10 per cent of foreign investments in any retirement savings plan is also punitive in that it would not give you the depth and scope necessary for achieving the capital gains that one would expect under the circumstances.

The Acting Chairman: Are there any questions on the registered retirement savings plan, honourable senators?

Senator Connolly (Ottawa West): Yes. Item (d), that the present provisions of the act relating to the taxation of the lump sum withdrawals and death benefits from registered retirement savings plans be retained. In the event of the death of a person contributing to a retirement savings plan, say, shortly after it comes into being, I take it what you are complaining about, doctor, is that when the money is withdrawn from the plan it is subject to income tax and estate tax as well in that case.

Dr. Sylvestre: That is right, sir. Under the present system the example as we set it out on page 20 shows that a person who is self-employed and has contributed $2,500 annually for a number of years would upon death see—say, as an example—his contributions having profited up to the amount of $50,000. Under the present system his tax liability is $7,500, but under the proposed system the tax would exceed $20,000, even if the new averaging provisions were used, and this is where we believe that the tax proposal is so punitive, because the $20,000 out of the $50,000 is rather closer to what one would have expected to pay if there had been no retirement savings plan.

The Acting Chairman: If there are no further questions, honourable senators, we will return to recommendation No. 5 on page 12 which deals with deemed realization on gifts between spouses.

Mr. Freamo: Mr. Chairman, I think this is a situation which was either ovelooked by the authorities of the White Paper or else they failed to read the legislation which you passed in 1968 relating to gift and estate taxes. The situation proposed in this section is really that if a man now would make a gift of a house to his wife and if there was a capital gain involved in that at the particular time of the gift, he would be required to pay tax on the amount of the capital gain involved. I am certain that this really was not the intent of the authors. We make the recommendation that a roll-over provision be introduced so that it would move to the wife at the same cost as his cost, and that eventually the tax would be paid. Otherwise we would have a situation where, if you wanted to make a gift to your wife of a house, you would have to make certain that you were in a position to pay the income tax on any profit that was involved at the time.

Senator Molson: So your recommendation is that there should not be a capital gains tax on the principal residence at all. And if that recommendation were accepted, this particular problem would not arise.

The Acting Chairman: Except in the case perhaps of a man who wanted to give his wife shares in a widely-held corporation.

Senator Molson: But that is not a residence.

The Acting Chairman: No, that is not a residence.

Senator Benidickson: I was just wondering if this was contemplated by the White Paper, because as far as the legislation in 1968 under gifting is concerned, it provides that from spouse to spouse a gift is not taxable. Would that not apply to a gift of money or a gift of a house or anything else?

The Acting Chairman: This recommendation does not really deal with the White Paper. It deals with the amendments to the gift tax section of the Income Tax Act in 1968, which you referred to, and it would appear from the operation of those provisions, tied in with the White Paper, that while spouses are free to give to one another without attracting gift tax, if they do there is a deemed realization and they could attract capital gains tax on items like shares that, say, have a higher value than on the day they are acquired. What they are suggesting here today is that

in a transfer between spouses, the property should pass at the original cost to the taxpayer so that there is no deemed realization at that time.

Now, if the donee then disposes of the property to somebody else there would be a realization at that point and tax would be residual.

Dr. Gosse: It is somewhat similar to the proposition we mentioned before whereby there should not be a tax on gains that were not realized. That is a principle we are following through on each of these instances.

The Acting Chairman: Are there any further questions on that recommendation? Then, senators, we move to recommendation No. 6 on page 13 which deals with the recapture of depreciation on bequests of property.

Mr. Freamo: Here we recommend that estate taxes and succession duties paid on the recapture of depreciation be allowed as a deduction from the proceeds of a subsequent sale of the relevant depreciable assets. This is to avoid the element of dutiable taxation that is involved under the proposal suggested in the White Paper and as it relates to the property left in an estate.

The Acting Chairman: Could you give us an example of how that might operate on a doctor's equipment?

Mr. Freamo: Perhaps the doctor's building might be a more suitable example.

This situation would be that if a doctor owned a building and left it to his wife and she subsequently sold it she should not be in that much different a position than if he had sold it immediately prior to his death. Under the present system, at his death on the depreciable property, while the whole amount of the property would be taken into consideration for estate taxes, there would be no recaptured depreciation involved. When the property is sold subsequently, recaptured depreciation is involved. Tax will be paid on that. We have already had estate taxes and succession duties paid as the property has gone through the estate tax process.

The suggestion is that the cost of that property in essence be increased by the amount of the succession duties and estate taxes paid.

The Acting Chairman: Is not the amount paid in succession duties added to the cost of the property under the White Paper proposal?

Mr. Freamo: No, it may have been in another section, but we could not see it in the White Paper proposals.

The Acting Chairman: But if it were, you are making a suggestion regarding not capital gains, but recaptured depreciation.

Mr. Freamo: Well, both are probably likely to be involved in the particular transaction.

Senator Benidickson: Our senior adviser is not with us today. I think it should be drawn to his attention that he gave us a note that this brief came in too late for his study.

The Acting Chairman: Perhaps, honourable senators, we could ask the Clerk to refer this particular recommendation to the senior tax adviser and ask him for his comments.

We move to recommendation No. 7, on page 14, which concerns the rates of estate tax.

Mr. Freamo: This particular recommendation anticipates the likelihood of the introduction of capital gains. We suggest that once a capital gains tax is introduced there is less reason for an estate tax. Perhaps it could not be completely eliminated initially, but as the operation of a capital gains tax takes place over a period of years, consideration should be given to reducing the amount of estate tax and eventually having it completely disappear.

Basically, it is supposed to represent a tax on capital which had been accumulated in large measure without the payment of tax. Now we are changing all those conditions and tax will have been paid on the accumulation of all our capital in the future.

The Acting Chairman: This would eliminate the double effect, I suppose in your profession, of a doctor who dies and whose assets have to be sold to pay estate taxes.

Mr. Freamo: Yes.

The Acting Chairman: We move on to recommendation No. 8 on page 16, which concerns the averaging of income under the White Paper.

Mr. Freamo: We do not believe that the recommendations contained in the White Paper with regard to averaging of incomes are going to be very meaningful to any Canadians. They are so restrictive in the way they apply that it would be a very unusual set of circumstances for a taxpayer to benefit appreciably.

We have situations where doctors are in practice for a period of years and then decide to take a year off, or perhaps a longer period and have some further retraining. Then they will go back into practice.

We think that income averaging is a good device if it is set out on a practical basis that Canadians can use. This is why we suggest that all taxpayers should be permitted to average their incomes on a basis similar to that now provided for farmers and fishermen in the Income Tax Act.

The Acting Chairman: We pass on to recommendation No. 9 on page 17, concerning fellowships, scholarships, bursaries and research grants not related to service.

Dr. Gosse: I think we are all aware that these come either from charitable organizations, which certainly are hard-pressed at the moment, always have been and probably always will be, or from Government sources. If these bursaries are to be taxed it means that the demand for an increase in their size will be apparent very quickly. Therefore the Government will just be taking it in on one hand and passing it out on the other.

There is no doubt that if our bursaries are taxed here and not in the United States it will be another reason why people will go to the United States for their bursaries. When they go there is more incitement for them to stay. While on the surface it looks as if it makes the taxation system more equitable, there is very little advantage to the Government and a very great disadvantage to the educational system of the country.

Dr. Robert Dixon, Royal College of Physicians and Surgeons of Canada: Mr. Chairman and honourable senators: This matter is of very real concern to the Royal College. There are just a few additional remarks I would like to add to those of Dr. Gosse.

The highest fellowship that is paid to our graduate students now is indeed marginal. For instance, the maximum scholarship that can be obtained from the Medical Research Council is about $8,000. This means that a man who has had research experience and has been graduated at least four years after his internship receives that, whereas his equivalent in the United States earns $12,000.

Our men at this level have as a rule to go outside the country to learn the special techniques and skills which we want them to bring back to our schools. This is one of the profits that comes to our country from these scholarships.

The cost of living in the United States has gone up dramatically. To quote an example of this that came to my attention yesterday, one of my young men is going down to the National Institute of Health there for his fourth year of graduate training, in this case in cardiology. He is a brilliant student. His scholarship from the Medical Research Council is $7,300. By the time this is changed into American dollars it will be about $7,000.

He went to seek a house where one of his colleagues attending the same institute lived two years ago. At that time the house rented for $250 and today it is $450. Of course, it is quite beyond his means.

It seems to me that to tax these scholarships is to really rob Canada of valuable training which it needs and which its medical schools need. These young men are sacrificing a great deal as it is. They could be earning, as you well know, very much more if they did not bother with this prolonged period of training. In my opinion to do anything to discourage them is unwise and extreme.

I am quite prepared to answer any questions you may have, but these are the points I would like to make. I am rather surprised that the Government, which is on the one hand trying to control inflation, would introduce an inflationary tax, particularly into its taxation system.

The Acting Chairman: Thank you, Dr. Dixon.

Senator Benidickson: You illustrated with a case of a search for a home in the United States. Who actually puts up the money for his scholarship to university?

Dr. Dixon: The Medical Research Council.

Senator Benidickson: Is that the Government?

Dr. Dixon: Yes.

Senator Benedickson: The Government puts it out with one hand and wants to take it back with another, and would be obliged, if they wanted the program to continue to increase the amounts of the scholarships.

Dr. Dixon: Right.

Senator Beaubien: We had better increase the taxes, too.

Senator Molson: This is well in accord with comments expressed before the committee by others, Mr. Chairman.

The Acting Chairman: I think, Senator Molson and honourable senators, we should perhaps move on to Recommendation No. 10 regarding the tax of non-profit organizations. Are there any comments?

Mr. Freamo: Only that, as an organization it costs us too much money to exist, but we do get fees from our members and some revenue from investments. If we pay tax on this investment revenue then we raise our fees to our members. They have a larger deduction from their income tax and, therefore, pay less tax back to the Government, so we are just chasing the same money all around the mulberry bush.

Dr. Gosse: And causing a lot of bookkeeping.

The Acting Chairman: Is it not true also that a lot of the grants which Dr. Dixon is referring to are paid by these non-profit organizations so that you are talking of a double tax, one on their income and the other on the recipient of the grant?

Mr. Freamo: You would be restricting the amount of money available for grants such as Dr. Dixon was talking about.

The Acting Chairman: And the grants would have to be increased because they are taxable in the hands of the recipient.

Mr. Freamo: Right.

Senator Molson: What are your views in regard to the association?

Mr. Freamo: As far as we can see they are legitimate business expenses. They do not sound like expense account living.

Senator Molson: I thought somebody else made the point that only unions and religious organizations were allowed to deduct their contributions.

The Acting Chairman: I think that may be so. I also think that unions and religious organizations and non-profit organizations are exempt from tax on their investment income.

Senator Molson: Thank you.

The Acting Chairman: If there are no further questions we can move to Recommendation No. 11 regarding automobile expenses.

Dr. Harnick: The present position which a physician has with regard to an automobile has, over the years, been of considerable concern to the Canadian Medical Association. It is our belief that an automobile is a necessary part of a doctor's equipment, and that whether he is in his automobile driving around town or whether he has his automobile available to him when he needs it for a specific purpose, the necessity of the automobile is a total one. We feel strongly that the automobile, in so far as a physician is concerned, should be a capital cost and totally deductible.

With respect to the question of the useage of the automobile—that is, the gasoline he uses in order to do certain mileage—we will accept, as everyone has, that an automobile is used for purposes other than that directly related to business, but that the cost relative to the useage should be a divided one. The cost relative to the ownership, or capital cost, should be totally a deductible item.

Senator Beaubien: What is the practice now?

Dr. Harnick: The practice now is to take the percentage of the capital cost deductible, and relate it to the use of the automobile—that is, the miles covered rather than the ownership or the necessity to own an automobile. We feel that these two should be divided; the capital cost as a 100 per cent deduction and the useage as a prorated figure depending upon how much it is used in practice and how much it is related to other pursuits.

Senator Beaubien: Would every doctor then have to make a deal with the department and say that he used his car 60 per cent for...

Dr. Harnick: That is what he is doing now.

Senator Beaubien: So everybody makes his own deal?

Dr. Harnick: That is correct, on both capital cost and mileage.

Senator Beaubien: It is usually on the whole thing; it is 60 per cent of everything?

Mr. Freamo: There must be other capital expenses to individuals in business which fall into the same category. If there is an overriding necessity for some item of property to be involved, we think that the capital cost allowance should be written off against it. Certainly the running expenses should be written off. You can say that 30 per cent of the gasoline was used for private use, but when the car is sitting outside while the doctor is in his office it is depreciating all the time. It is

there so that, when he gets a call, he can go and answer it.

Senator Beaubien: Can you tell us what the practice is in the United States?

Mr. Freamo: I do not know, sir.

Sanator Blois: It is interesting to hear the honourable gentlemen speak on this subject. Two or three weeks ago I happened to be in a group of three medical men and this subject came up. Two of them only took office calls, and they were talking of a similar situation. They were wondering why they should get an allowance for their automobiles when they do not make calls at all. Perhaps you could explain that.

Mr. Freamo: If all they do is take office calls and there is no overriding necessity for the automobile, it should not come into this category.

Senator Blois: You are not suggesting that all medical men get it?

Mr. Freamo: For those who need it in their practice, it is essential.

Senator Blois: You are not suggesting that all medical people should get it.

Mr. Freamo: No.

The Acting Chairman: We can move on to Recommendation No. 13, which deals with conventions. We have already dealt with Recommendation No. 12.

Dr. Matthews: Mr. Chairman and honourable senators, I imagine you have had quite a few presentations made on the subject of conventions. We feel strongly that these should remain as a deductible expense. So far as we are concerned conventions serve as a place where we discuss our professional work is primarily the health of the public and the people. We have listed certain areas that we have become concerned with at conventions where we have developed a policy. There are a great many such areas. This brief, I suppose you could say, is a matter of self-interest, but most of the subjects that we concern ourselves with have a value to the people of Canada. Some of them are listed here. We presented our brief on alcohol and driving to the Department of Justice. It dealt with the level of alcohol which we supported as making a distinction between impairment and non-impairment. We presented a brief on drug abuse. We presented a brief on abortions. We presented a brief on smoking. These briefs don't just come out of a hat. They take a lot of time and a lot of study by committees and they take a lot of hashing out at our conventions, until we can say that this is what 21,000 Canadian doctors think. This is our opinion and we think it means something when these issues have been decided.

The Acting Chairman: You represent 21,000 doctors out of how many?

Dr. Matthews: Out of about 26,000 or perhaps a few more practising doctors. We agree that the convention expenses are liable to abuse. The ruling now is that a doctor can go to one continental convention and one foreign convention per year. Many of these conventions are bona fide conventions where the doctors go as an educational experience and in order to broaden their ideas of professional service. But we would offer to sit down with the department and work out a system of ground rules that could be applied to conventions to correct any possible abuses that do come in. But we think to cut the whole thing out would seriously jeopardize this particular part of our activity, and we think it would be everybody's loss. That is all I have to say, Mr. Chairman.

The Acting Chairman: Thank you, Dr. Matthews.

Senator Phillips (Rigaud): Mr. Chairman, first I wish to apologize as a member of this committee for my inability to be present. Some of us had to be in the House on current legislation. On this whole question of conventions we have been giving considerable consideration to this subject matter, of course. When you say you would be ready to discuss ground rules with the department, have you in mind any particular thought as to ground rules? If you had, it could be of help to this committee for its use in due course.

Dr. Matthews: Well, we do mention two abuses or two areas where there may be the possibility of some abuse. One area is where people enroll in conventions in a language other than their ordinary language of communication. Another is if people enroll in a convention dealing with a speciality in which they do not practise. Those are obvious areas of abuse. There may be others. We should like to think about it some more, after which we would very likely have more detailed representations to make in this regard.

Senator Phillips (Rigaud): Have you had problems concerning the expenses allocated to

wives joining their husbands on conventions? Have their expenses been allowed?

Mr. Freamo: No, they have not.

Senator Phillips (Rigaud): Have you any views? It has been suggested that they are perfectly legitimate expenses, within reason, from the point of view of a doctor or a lawyer going to a convention. That there is some degree of propriety in having their wives with them and being associated with them even in terms of social functions. This enables professional men to get to know each other more closely and have the benefit of new scientific experience in the case of doctors and forensic advances in the case of lawyers.

In other words, there are some who have the view that such expenses should be allowed.

Dr. Matthews: We would certainly not object to them being allowed, but this is not our presentation at the present time.

The Acting Chairman: The question is whether or not you have any views on that?

Dr. Matthews: The Canadian Medical Association has no views on it.

The Acting Chairman: Senator Phillips, do you wish the Canadian Medical Association to see if it could develop some ground rules for this committee?

Senator Phillips (Rigaud): Yes, I think it would be very helpful, because the whole question of convention expenses will be considered by this committee as a special heading in a forthcoming report. We are accumulating as much data as we possibly can in order to ascertain the views and interest of our fellow citizens of Canada on the subject.

I have not had the advantage of listening to your verbal representations, although I have read your brief. It would be helpful indeed, after due consideration, if you could come up with a series of suggestions with respect to what should be allowed as expenses.

The Acting Chairman: Senator Phillips, we have Dr. Dixon, the President of The Royal College of Physicians and Surgeons of Canada, here. He would like to speak to this particular point which you have raised.

Dr. Dixon: Mr. Chairman and honourable senators, I really want to speak to the whole question of conventions and more particularly to that of The Royal College annual meetings and its regional meetings.

In the first place, we support entirely what has been said by the representatives of the Canadian Medical Association. Our own situation differs a little in that our meetings are almost entirely educational. Our annual meeting has a business meeting for the certificants of the college, which lasts about an hour at breakfast. The annual meeting of the fellows lasts about three hours, so it is four hours in the two days. The rest of the programs are designed for the continuing education of the members of the College, which we consider of tremendous importance.

The regional meetings are entirely concerned with continuing education, except for a luncheon meeting where the president says a few words. The importance of continuing education in medicine can hardly be over-stressed.

I would like to make a couple of points to show why I think everyone can realize that it is of great importance. The Royal College, like other organizations concerned in medical education, has become increasingly concerned at the lag which exists between the development of the new discoveries in medicine and the introduction of the new methods and ideas to the general practice and to the delivery of health care. No one considers the rate in which new knowledge is coming into being at this time, which is almost frightening. It has been put rather dramatically that if you take as a beginning the year of the birth of Christ, then the first doubling of knowledge in the natural and physical sciences took place about 1700, the next doubling took place about 1850, the next in 1950, the next in 1960 and the next in 1965. What it is doing now I do not know. It is not slowing up.

When a doctor goes to a meeting it means that he has to close his office which stops his income. This is highly undesirable not only to him, but to all of the people he cares for. We feel therefore that deductions for any duly properly constituted program of medical education should be favoured in every way possible. These are the points I wish to make.

Senator Phillips: May I put another question? In considering this whole question involving professional men generally rather than business men—I am not saying this for the purpose of embarrassing any of the doctors—do you think that because of your importance in looking after the health of people that you should be entitled to special considerations, I am putting that question

because you may be entitled to that consideration. Nothing is more important than human life. Do you identify yourself with the professional classes generally.

The Acting Chairman: Are you speaking of any particular context, Senator Phillips.

Senator Phillips: I am wondering whether the doctors feel that the necessity to be up-to-date in terms of scientific information and data so important that medical journals, papers, and so on are not in themselves sufficient to bring them en courant, whereas lawyers have their law journals and systems whereby they get information on reported cases from all over the world. Engineers have their technical journals, and so on. I am wondering whether you feel you are entitled to special consideration as against professional men generally.

Dr. Dixon: Yes, Mr. Chairman. I do not know that it is really possible to say that positions are in an entirely different category. I suppose if an egineer builds a bridge and through lack of knowledge of a new material which he is using the bridge collapses and kills 100 people, that is pretty bad too. I think in all the fields involving the natural and physical sciences today that advances are going on so quickly that people are bound to be out of date very quickly, within a matter of a few years, unless their knowledge is kept up in some way, and I would not confine it to physicians.

Senator Phillips (Rigaud): May I put one further question?

The Acting Chairman: I wonder, Senator Phillips, if perhaps you would like to hear Dr. Matthews, who is the President of the C.M.A., on the same subject?

Senator Phillips (Rigaud): Yes.

Dr. Matthews: I think you have to ask what we are doing ourselves. If you look at the medical colleges, the universities, almost every one of them has a department of continuing education, with full time people in charge, who are putting on courses, with various kinds of seminars all the time. That happens in every university for the graduates, not necessarily only for resident staff, but to attract practising doctors back to university for continuing post-graduate medical education. That is going on all the time. I do not think there is another discipline that is involved in continuing medical education as we are. If you ask me, I would say that I think we have a special position in that area.

Senator Benidickson: Did not the Ontario Commission on Health Disciplines, which studied certain problems for some eight years, say the other day that there should be some compulsory form of retraining?

Dr. Matthews: Yes, they did. They said there should be a compulsory amount of post-graduate study required of every practising doctor.

Senator Benidickson: Periodically.

Dr. Matthews: Dr. Rice is not here to speak for the College of Family Physicians, but one of their conditions of membership is that the member has to put in so much post-graduate training every two years. I think we are doing a lot for ourselves that other disciplines do not feel is necessary.

Senator Phillips (Rigaud): I should like to pursue just one more aspect, because I may say that the whole of this matter was the subject of a discussion between Senator Hayden and myself today; this whole question of expenses was the subject of discussion, both of us knowing that we would not be here. I did not raise this with him, but I am raising it now. Although I am a lawyer, law officers do not close up when there is a convention and some people leave to go to it. The same applies to architects and chartered accountants. But when a doctor leaves to go to a convention, usually his patients are a little resentful if somebody else turns up during his absence, whatever his specialty may be. There may be something to the point. I say this so that honourable senators may read this in the record in due course, particularly those who are not present here now. We may want to give consideration to the point that you fall within a special category. I do not say that would be the conclusion. I am simply alerting you to the thought that some people may favour entertaining that view. Whether the Government accept it is another matter. We can only deal with our own jurisdiction and what we say on the subject.

Mr. Freamo: I think it should be pointed out that there are two types of medical convention. There is the type Dr. Dixon referred to, which is primarily and largely for medical education, and the other type, of which the C.M.A. annual meeting is a very good example, which is primarily the business of medicine as it affects the community as a whole,

as it affects the Canadian people. Those are the things Dr. Matthews referred to when he mentioned all the briefs we have submitted over the years to governments at various levels for the betterment of the community, the prevention of various diseases and so on.

There are two real types, and perhaps they could not be incorporated into one thought. But both types are very important to the community and the people of Canada.

The Acting Chairman: In effect in our discussion we have been dealing with both continuing medical education and convention expenses, but I think we have covered the ground of both fairly well. Are there any further questions?

I might point out to Senator Phillips (Rigaud) that Dr. Matthews has agreed that the C.M.A. might be able to develop for this committee ground rules for the deductibility of convention expenses.

Senator Phillips (Rigaud): And they will let us have those in due course?

The Acting Chairman: We will get them in due course. Is that right, Dr. Matthews?

Dr. Matthews: Yes, I would be happy to undertake that. Could you give me an idea of the time?

Senator Phillips (Rigaud): I think it should be made available, to be effective, certainly not later than the end of May.

Dr. Matthews: Certainly.

Mr. Freamo: Mr. Chairman, just one other comment. We have been talking about two different things. If we forget about conventions for the moment and talk about the continuing problem of general medical education. The honourable senator asked a question as to whether there is a distinction between medicine and other professional groups. I would just offer this comment that in medicine many things have to be shown to be learned. It is not enough to read your journal; you have to go and actually participate in an operation to learn how it is being done. This is why this business of going away for a course for one or two or three or four weeks is essential. Everybody reads his journals and participates in local hospital activities but you really have to go away. You cannot, as a lawyer might be able to do, sit in your office and read judgments and be brought up to date.

Senator Phillips (Rigaud): That is why I wanted to get the differenciation because it might have a bearing.

The Acting Chairman: Any further questions? Senator Smith.

Senator Smith: Mr. Chairman, if I may make a few observations, as I recall reading the record of the submissions made to this committee by the Canadian Dental Association and I might say that it is a profession that I was associated with much more closely earlier than I have been in the last 15 years, and when they discussed this particular problem, the record indicates they felt that the maximum amount deductible should be of the order of $5,000 or $6,000. I thought that was rather high in view of my knowledge of that profession. I am very interested indeed to see the maximum suggested by this Organization is $2,000 which I think is a very modest sum and I think something like this should be found much more readily acceptable and it would appear to me to be much more reasonable. Through my rather close knowledge of the medical profession, I thought something like that should be put on the record at this time. I was quite disturbed that the dental profession should indicate that they would require $5,000 or $6,000 to further and continue their education.

The Acting Chairman: Any other comments or questions? Any further comments from you, gentlemen?

Well, on behalf of the committee, Dr. Matthews, I would like to thank you and your colleagues very much for being here and presenting this brief and submitting so readily to our questions.

Whereupon the committee adjourned.

APPENDIX "A"

BRIEF

TO

THE SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

TRIZEC CORPORATION LTD.

April 17, 1970

SUMMARY OF PROPOSALS OF TRIZEC CORPORATION LTD. (Trizec) IN RESPECT OF THE WHITE PAPER ON TAX REFORM

The following is a summary of the various proposals made by Trizec in its attached brief to the Committee:

Trizec recommends that -

GENERAL

1. The legislation reflecting the White Paper as finally decided be brought in over a period of years to avoid undue disruption to the fabric of the economy.

2. During the period of the gradual introduction of such legislation, the administrative branch of the Income Tax Department be given the opportunity to gradually assimilate the very substantial changes in philosophy and tax procedure.

3. Provision should be made under the legislation for the issuance by the Department of National Revenue of binding rulings based on stated facts, so that taxpayers may proceed safely with proposed actions under the new law.

CAPITAL GAINS

1. Capital gains and losses should be made subject to the Income Tax Act.

2. Capital assets (which by definition would give rise to capital gain or capital loss) should be defined as all assets not otherwise held primarily for sale to customers in the ordinary course of business.

3. Difference should be acknowledged between the taxation of short term capital gains and losses and long term capital gains and losses, but no differentiation should be made between closely and widely held Canadian corporations.

4. Short term capital gains and losses should be those arising from the sale or exchange of capital assets held for less than one year and such short term gains and losses should be fully brought into income and otherwise taxed under the Income Tax Act in the same way as other business income.

5. Long term capital gains and losses should be those

arising from the sale or exchange of capital assets held for one year or more and such long term gains and losses should be brought into income at 50% of the amount of the gain or loss and otherwise taxed under the Income Tax Act in the same way as other business income. The effect of this will be, for taxpayers in the 50% bracket, that long term capital gains will be taxable at 25% and long term capital losses will be deductible to the extent of one-half of such losses.

6. The cost basis for capital gains and losses as established on the valuation date should be the higher of the historical cost or value of each asset on valuation date, with no capital gain or loss being recognized until historical cost is achieved.

7. Capital gains and losses of non-residents of Canada should continue to be non-taxable by Canada except where the non-resident taxpayer is carrying on business in Canada or, in the case of treaty countries, has a permanent establishment in Canada from whence such capital gain or loss derives.

8. The White Paper doctrines of tax on unrealized appreciation should not be enacted as law. This would eliminate (a) the five year revaluation rule for shares of widely held Canadian corporations (Section 3.33), (b) the deemed realization of capital gain or loss on individuals giving up Canadian residence (Section 3.40), and (c) the deemed realization of capital gain or loss on the value of gifts (Section 3.41).

9. The deductibility of interest, the adjustment of cost basis for non-deductible interest and other expenses, and generally the whole concept of cost basis of assets for capital gains and losses should be clarified by Government.

10. The rollover provisions of Section 3.43 to 3.52 of the White Paper, and particularly Section 3.47, should be substantially amended so as to permit greater ease of tax free incorporations and reorganizations.

11. More extensive averaging provisions should be provided to equate the impact of the proposed capital gains tax and provision should be made to assimilate and place capital gains and losses under the pool concept in the same manner as recapture of depreciation and terminal loss.

CORPORATE REPORTING

1. Corporations resident in Canada should be entitled to elect to file consolidated returns with chosen domestic or foreign companies in which they own 50% (25% in the case of foreign companies) or more of the voting shares or where consolidation is permitted as a matter of sound accounting practice.

CORPORATE DISTRIBUTIONS

1. The present system of taxing corporate dividends to individual, corporate and non-resident recipients should be basically maintained.

2. No differentiation should be made between widely held Canadian corporations and closely held Canadian corporations.

3. Within the limits hereinafter set forth the taxation of dividends should not depend on the actual tax paid by the declaring company.

4. Inter-corporate dividends from consolidated defined "subsidiaries" should be tax free.

5. All other inter-corporate dividends (other than from unconsolidated foreign subsidiaries owned 25% or more by the recipient company which should continue to be tax free) should be taxed at a flat rate of between 5% and $7\frac{1}{2}$%.

6. If Government insists on the grossing up rule for dividends the $2\frac{1}{2}$ year rule of Section 4.27 of the White Paper should be eliminated.

PROPERTY EXPENSES AND CAPITAL COST ALLOWANCE

1. The proposals of Section 5.17 of the White Paper should be cancelled.

2. All profits and losses on real estate account should be fully off-settable against all income, particularly in the case of taxpayers engaged in the property business.

In particular, capital cost allowance, interest and property taxes should be fully deductible in the computation of income to all taxpayers, including particularly taxpayers in the property business.

3. The suggestion of the White Paper that a separate class of property for depreciation purposes be created for each rental building that exceeds $50,000 or more should be eliminated.

4. The pool concept for recapture of depreciation and terminal loss should be retained and should be extended to capital gains and losses.

5. Whatever new rules are enacted pursuant to the White Paper should not apply to real property now in existence or to projects for which commitments have been made as long as the beneficial ownership of such real property and/or projects continues to be substantially vested in the persons presently owning same.

INTRODUCTION

Trizec Corporation Ltd. (Trizec) was incorporated in 1960 for the purposes of developing and investing in real estate in Canada. Its best known asset is Place Ville Marie in Montreal which, many people believe, was responsible for the construction boom which completely revitalized the central core of Montreal. Trizec has constructed properties having a cost in excess of $165,000,000 and has, in addition, acquired property constructed by others with the result that its total investment in real estate at the present time amounts to $226,000,000. Trizec is a widely held corporation and at least 54% of its common shares are owned by foreign investors.

This construction has given employment to many thousands of Canadians and Trizec employs approximately 2,000 people in the maintenance of its properties. These figures when combined with those of other real estate investors and developers are drawn to the attention of the Committee to emphasize the importance of the real estate industry to the economy of Canada and show the necessity of ensuring the elimination of those sections of the White Paper which would

prejudice in a material fashion the raising of capital funds needed to sustain the real estate industry. Trizec believes that there are many sections of the White Paper, which if enacted in the present form would make it virtually impossible to obtain the necessary capital funds for development in Canada and this is its principal reason in submitting this Brief to the Committee. If the availability of capital funds should decrease due to provisions of the White Paper, the only real alternative of real estate companies would be to increase the yields to investors for new developments. This increase would have a major inflationary effect on the Canadian economy, causing needless prejudice to Canadian taxpayers.

Trizec feels generally that the White Paper on proposals for tax reform submitted by The Honorable E. J. Benson, Minister of Finance, in 1969 would, if in due course reflected in legislation, cause a number of detrimental results, not only to Trizec itself, but generally to all taxpayers in Canada. It is not the desire of Trizec to bring before this Committee all of the aspects of the White Paper on which it might conceivably have comments, but rather to restrict itself primarily to those aspects of the White Paper which directly

affect Trizec. Of necessity, however, such an approach cannot help but impinge from time to time on matters of more general import, and Trizec has felt it necessary in this brief to make certain specific recommendations on matters not directly related to its own problems where these aspects of the White Paper are considered by Trizec to affect the Canadian policy in general.

With the foregoing in mind, Trizec feels that when dealing with any particular taxpayer, or group of taxpayers, the effect of the White Paper can be divided into four general categories.

I. The effect on such taxpayers by virtue of the overall results which will arise under the White Paper legislation.

II. The effect on such taxpayers of particular legislation pursuant to the White Paper, which legislation will affect a large body of the taxpaying public and will have a serious effect on the taxpayers in question.

III. The effect on such taxpayers of particular legislation pursuant to the White Paper which has a more direct effect on the taxpayers in question than on most other groups of the taxpaying public.

IV. The effect on such taxpayers of the effective retroactivity of legislation pursuant to the White Paper insofar as it affects prior investments and developments conceived pursuant to the prior law.

It is obvious that the foregoing four categories are not mutually exclusive and the particular subject matters may overlap. In general, however, it has been the attempt of this brief to divide the representations of Trizec under the above four headings and to discuss them separately, except for category IV, which, because of its nature, is included in the general discussion under the other headings.

I. THE OVERALL RESULTS

Regardless of the merits of the White Paper as such, Trizec is of the opinion that a very substantial change to the general tax law of Canada at this time will lead to serious adverse consequences. There can be little doubt that if all or substantially all of the White Paper is reflected in legislation, such legislation will be highly imperfect until, over a number of years, experience has shown whether the law has been properly and fairly drafted. During this period and as a result of the foregoing, there will be great uncertainty as to the actual effects of particular provisions, with the result that commerce in general will have a tendency to retrench due to this uncertainty.

Particularly in the real estate field where the tax consequences of investment are such an important function of the decision making process, this general uncertainty, when combined with high interest rates and other risk factors, could greatly contribute to the deterioration of real estate development, including those areas where the present anti-inflation restrictions are not to be imposed. While Government

policy today dictates restraint on certain real estate development, it would be short-sighted to perpetuate this state of affairs through a philosophy of income tax which would deprive the country of access to real estate development during deflationary periods.

Even if the ultimate decision to legislate all or substantially all of the White Paper is accepted, not only the effect of such legislation but also the subject matter should be spread out over a number of years so as to gradually change the present income tax law to the desired new structure. This would have the advantage not only of giving a gradual testing period as to the effect of the new legislation, but also of building up a sufficient administrative cadre to properly administer the new legislation.

Even if only a small part of the proposals of the White Paper become law, the novelty of the procedures and the absence of any body of case law will make the decision making process a very risky matter for taxpayers. Under the present law, the growing complexity of the legislation and the varying applications of the existing provisions of

the Income Tax Act, and particularly the tax avoidance sections, have already thrown a burden on taxpayers and tax advisers which it would be well to remove. Trizec, therefore, recommends that the Income Tax Act be amended so as to authorize the Department of National Revenue to issue binding rulings based on stated facts supplied by taxpayers to the Department. This legislation should be drafted in a way which will induce the Department to give such rulings, so that the understandable tendency of the Department not to prejudge will not overcome the obligation to issue such rulings in acceptable instances.

In the highly sensitive and complex economy of Canada the basic tax procedures of many years cannot be overturned and a whole new philosophy of taxation introduced without causing tremendous stresses in the commercial and financial community. In the real estate field, and particularly for the major developers, such as Trizec, certainty, or at least relative certainty, is an absolute necessity for the proper carrying out of their business since major developments, because of their huge capital investment, can only be properly amortized over long periods of time. If there is a chaotic tax structure, the result will be that, except where short term

clear profits are envisaged, real estate companies will have a tendency to retrench and not proceed with the orderly development of their facet of the economy.

II. GENERAL APPLICATION OF SPECIFIC PROVISIONS

Except for the areas of the White Paper dealing with individuals, trusts, etc., there is hardly any facet of the White Paper which does not, in some way, fall within this second category. The following areas, however, seem to be particularly relative to Trizec although, as noted, these areas also have considerable effect on the taxpaying public in general.

a) Capital Gains - General

In almost every Western country and in the United States in particular, the taxing systems have always acknowledged the merit of applying different taxing procedures to current income receipts and capital appreciation or depreciation. The divergence of the White Paper on this subject can only reduce the funds available for the expansion of Canadian development.

It seems to be a generally accepted principle at this time, to which Trizec subscribes, that capital gains should be made subject to some sort of tax. Since, however, in most other Western countries the differentiation between a tax on general income and a tax on capital accretion has been realized and reflected in a lower rate of tax for the latter, Trizec strongly recommends that Canada should not vote itself out of the international investing community by the procedure contemplated by the White Paper.

There can be no question that if the capital gains tax is enacted in its proposed form, the future of real estate development will be very adversely affected. The Committee need not be told of the very high risk factor in any real estate development and if the hoped for capital accretion over a period of years is to be taxed as ordinary income, one of the basic elements in

accepting such a risk will have disappeared. In an era when high income yields are safely obtainable through lending money to governments or to industrial entities, the desirability of making high risk capital investments to equate more or less the same yield will be seriously affected if there is removed from the aegis of the investor's thinking the possibility of capital accretion and realization at a lower rate than would apply to ordinary yield income.

It is no answer to these objections that capital losses will be fully deductible in the computation of income since persons involved on a continuing basis in the development of real property will, in the normal course, not sell their loss assets. As a result of the foregoing, the availability of a capital loss to such persons is never as great as the potential of a capital gain. While the availability of capital losses as a deduction from income is a necessary adjunct to the

taxation of capital gains, it does not eliminate the adverse effects on the availability of risk capital invested for the purpose of making expected gains and a maximum take home amount. Moreover, in the case of non-resident investors, the availability of such a loss would normally be a useless benefit, since they rarely would have an equivalent gain on income in Canada against which to offset such loss.

b) Capital Gains - Valuation Date

The concept of fixing values on the valuation date will unquestionably lead to some serious inequities on taxpayers. Leaving aside the difficult question of how to fix values in an area of endeavour such as real estate, it must be admitted lamentably that companies such as Trizec hold today assets which have a value below their cost. Except in the limited area of certain debt securities, no provision has been made in the White Paper to permit the cost basis for capital gains to be the higher of cost or the value

on valuation date. The result of this will be that when property is subsequently sold, the capital gains tax will apply to the difference between the value on valuation date and the realized amount of the sale, even though economically the transaction may have given rise to a loss or a much lesser gain. Trizec respectfully submits, on this specific point, that all assets on valuation date be given a cost basis for capital gains tax equal to the higher of their historical cost or value, with no capital gain or loss being recognized until historical cost is achieved.

c) Capital Gains - WHC, CHC and the Five Year Revaluation Rule

Notwithstanding the fact that Trizec is a widely held Canadian corporation (WHC), and will by definition benefit from the lower capital gains tax on its shares, it opposes the distinction between WHC and closely held Canadian corporations (CHC), the failure to differentiate between short

term and long term capital gains at different tax rates, and the five year revaluation rule of Section 3.33 et seq. Whatever tax benefits Trizec and other WHC might obtain by virtue of the advantages to their shareholders on both capital gains and dividends, Trizec feels that the imposition of more onerous rules on CHC and unincorporated businesses, and particularly more onerous capital gains provisions, is not something which it can support because of the general overall detriment to small business and the economy.

Companies like Trizec can only function in a healthy economic atmosphere and if small business and small real estate companies are to be prejudiced (including, for instance, the removal of the low tax rate in the low corporate bracket) such prejudice must, in the long run, hurt companies such as Trizec. Trizec submits that it and its shareholders ask for no special benefits by virtue of being a WHC and they are

prepared to be taxed as all other corporations and shareholders in Canada on their respective realized gains and losses, without distinguishing between WHC and CHC. Conversely, they do not wish to be affected by an artificial five year revaluation rule which would impose a tax upon shareholders without actual realization of gain or loss.

The possibility of capital gains at a lower tax rate than annual income is, in the opinion of Trizec, a vital ingredient of the incentive to invest. A large part of the real estate business of Canada is carried on by CHC or by unincorporated business and a major motivation of this development potential is the possibility of capital gain. To impose upon CHC and unincorporated business a higher rate of capital gains tax than upon the stock trader who plays the market in shares of WHC, seems to Trizec to be a perversion of the basic reforms contemplated by the White Paper. The starting of new real estate developments by

small entrepreneurs is, at best, a hazardous procedure, with a high risk potential of loss and a relatively long time period before gain can be realized. For such investors the incentives to invest will be greatly reduced by a capital gains tax at full rates, when, by comparison, they could invest in high dividend paying shares of WHC, with capital gains tax at only one-half the rate of CHC.

In summary, therefore, Trizec opposes the artificial distinction between WHC and CHC and the different tax effects given to capital gains, capital losses and dividends on their respective shares, since (i) the distinction and the reasons as to why any given company is publicly held or not publicly held are not the proper basis for different treatment, (ii) most small business and real estate development is done by CHC or unincorporated business and should not suffer a higher rate of capital gains tax than shares of publicly held and normally larger and wealthier companies, (iii) to give a benefit to the stock trader in shares of WHC who normally contributes nothing to the operations of the WHC

as against the working individual who operates his own business, directly or through a CHC, violates the general concept of reform set forth in the White Paper. Trizec, therefore, recommends that following the tradition of all other countries imposing capital gains tax, no distinction be made between types of business assets and shares in imposing the tax, but that a differentiation be made between gains realized on the short term turnover and those developed over a longer period.

d) <u>Capital Gains - Deemed Realization on Non-Residence</u>

Trizec objects strongly to the proposal of Section 3.40 of the White Paper and the deemed realization of capital gain on persons leaving Canada. The Canadian economy and the Canadian standard of living has benefited substantially in the past from the unrestrained flow of Canadians to other countries and from the immigration to Canada of the nationals of other countries. The imposition of the rule of Section 3.40 of the White Paper would, in the opinion

of Trizec, substantially reduce the inter-flow of Canadians and foreigners and the resultant educational and experience benefits obtained for this country as a result thereof.

e) <u>Capital Gains - The Foreign Investor</u>

The propositions of Section 6.43 et seq of the White Paper that non-resident shareholders of CHC and 25% or more owned WHC will be subject to tax in Canada when they sell their shares will seriously affect the possibility of obtaining large foreign investors to participate in the various operations of companies such as Trizec and its subsidiaries. When this is compounded with the fact that if such investment is found for CHC subsidiaries of the WHC, the ability to elect to treat the subsidiary as a partnership is eliminated and in consequence, necessary foreign investment in this field will become very difficult to find.

The taxing of capital gains of non-resident

shareholders does not accord with the principles and practices of virtually all western countries. Only West Germany and the Netherlands attempt to impose such a tax (with, we understand, something less than complete success) and neither the United States nor the United Kingdom imposes such a tax. The OECD Model Treaty (accepted by Canada) does not permit the imposition of such a tax and, in any event, through the use of bearer shares or unrecorded transfers it is apparent that a substantial number of the transactions in question will not be reported and will not be enforceable as a matter of international tax law. Trizec is of the opinion that in the competitive search for foreign capital investment, Canada cannot afford the luxury of imposing such a tax which the United States, for instance, does not impose.

The effect of the foregoing is accentuated by the apparent proposal of the White Paper that the five year revaluation rule will apply to non-

resident shareholders owning more than twenty-five per cent of a WHC. In most, if not all instances, this tax upon unrealized gains, if imposed upon the foreign shareholder, will not be creditable by such foreign shareholder against his domestic taxes and may even result in a complete double taxation if such foreign shareholder, in due course, realizes a gain on such shares and is subject to a domestic tax on such realized gain. It appears to Trizec that this highly onerous provision will either result in a major restriction on foreign investment in Canadian companies generally, or at the very least, promote investment only in CHC. The chances of participation by the Canadian public in Canadian subsidiaries of foreign companies would obviously be very seriously diminished since it is hard to conceive of any major foreign investor going public with his CHC where the results would be the creation of such onerous Canadian tax liability.

The White Paper states that most of the existing income tax treaties between Canada and foreign countries will be re-negotiated in order to eliminate the present protection given to foreigners against taxation of their capital gains in Canada. The Committee can easily envisage the reaction of existing foreign investors who over many years have placed substantial monies in Canada based on the reasonable assumption that they were protected both by Canadian law and by treaty provision from taxation on their ultimate capital gains. To retroactively change the status of these investors may be possible legally, but it can hardly give any confidence to future investors in the stability of the Canadian legal system and the continuity of our undertakings. This type of retroactive approach, while in the short run seemingly acceptable, cannot but seriously affect our stature in the international investing community.

f) Capital Gains - The Adjustment of Cost Basis for Non-Residents

The White Paper does not explain how deductibility of interest will be treated under the proposed legislation. The absence of such treatment is an omission which Trizec feels should be remedied, since if the current provisions of the income tax law were to remain, they could result in considerable inequities if the proposals of the White Paper are adopted.

At present, interest is deductible except when borrowed money has been used to purchase assets, the income from which is exempt, or where the interest is paid in respect of borrowed money used for non-business reasons. If the White Paper comes into effect, no property of residents of Canada will be exempt from the capital gains tax and the tests of exempt income will, of course, substantially change. Thus, for instance, dividends from fully tax paying Canadian companies to individuals and corporations will, in most instances, constitute partially or

totally tax free receipts, whereas dividends from non-tax paying Canadian companies will constitute taxable receipts to both individuals and corporations. Will interest, therefore, used to borrow money to acquire shares of Canadian companies be deductible in all instances, non-deductible in all instances on specific annual tests as to whether the company in question is a WHC or a CHC or whether dividends in any year from the particular company in question are taxable or non-taxable? The foregoing aspect deals, however, only with the question of interest deductibility as a current expense and does not take into account the whole question of the applicability of interest to the cost basis of assets for capital gains purposes. Thus, for instance, will interest on borrowed money used to acquire non-business property if not deductible for the purposes of computation of income, nevertheless be an addition to the capital cost of the property for capital gains purposes?

The abovementioned questions are only some of a very substantial number that could be asked in this area, none of which are covered by the White Paper. What little help can be derived from the White Paper provisions is on the negative side. Thus, for instance, in Section 5.17 deductibility of interest (as well as capital cost allowance and property taxes) are specifically eliminated in certain cases as a deduction in the computation of income. While this, in itself, is in the opinion of Trizec, unfair and unwarranted (see Section III below), at the very least it would seem that if these particular items are not to be permitted as deductions in the computation of annual income, they should be subject to capitalization into the cost basis of the property in question for capital gains purposes. If this is not done, the result would be to create a vast new area of "nothings", the elimination of which is, in the case of depreciable property, specifically stated to be one of the purposes of the White Paper. (Sections 5.4 to 5.8).

g) Capital Gains - Tax Free Reorganizations

An example of the narrowness of certain sections of the White Paper is found in the rollover provisions of Sections 3.43 to 3.52, and particularly Section 3.47. After providing what appears in essence to be wide permissions for tax free incorporations and reorganizations, the White Paper then removes from the accepted category a large number of fact situations that could normally be met in a complex society. Thus, there are excluded from permitted rollovers -

(i) transfers from a taxpayer to a corporation where such taxpayer owns less than all of the shares of every class of the corporation,

(ii) transfers to a foreign corporation,

(iii) transfers to a WHC, and

(iv) transfers of shares of a WHC (subject to apparently some easing on this point under Section 3.52).

It can be seen from the above that effectively there will be comparatively few corporate transactions that will qualify for the rollover provisions, and perhaps the most damaging portion of the White Paper analysis in this respect is provided under Section 3.47 as to why it was necessary to so restrict the rollover provisions. In explaining the exclusion of widely held corporations from the ambit of most rollover provisions the White Paper gives as the reason for this that "the provisions necessary to achieve the proper ultimate result would be too complex". Is it, therefore, the attitude of the White Paper to introduce a highly complex taxation system, and then to avoid equitable relief in favour of the taxpayers on the grounds that it is too complex?

Without attempting to stress the particular inequities of any one or more of the above exclusions, it is worth while to note a few of the results that would happen if Section 3.47 of the

White Paper as now drafted were to result in legislation. The holders of the shares of a CHC would be effectively barred from transferring their shares to a WHC for shares of the WHC, since such transfer would result in immediate realization of gain and tax. Simultaneously, of course, no WHC would be willing to enter into such a transaction, even if the holders of the shares of the CHC were willing, since, presumably, to pay their taxes, such holders upon receipt of their shares of the WHC would have to dump a considerable portion thereof on the market and would, therefore presumably, depress the price of the shares of the WHC. The administration convenience, therefore, of the White Paper is to seriously affect the chances of a CHC to sell out their holdings to public companies thereby excluding from the commerce of our country a whole vast area of normal and proper business transactions.

h) <u>Capital Gains - A Suggested Solution</u>

Trizec agrees in principle that some form of capital gains tax should be introduced into the Income Tax Act of Canada. Trizec does believe, however, that the taxation of such capital gains should not be subject to the same rules and rates as those set forth for ordinary income. With this general premise in mind, Trizec recommends that the Income Tax Act of Canada be amended to the following effect:

(i) A definition of capital assets should be enacted. This probably could follow the lines set forth in the United States Internal Revenue Code which defines non capital assets as being property held primarily for sale to customers in the ordinary course of business. A definition of this nature would introduce considerable certainty into the law and remove from the necessary review of the Tax Appeal Board and the courts a vast

majority of the cases that now come before them as to what constitutes or does not constitute a capital asset.

(ii) A different rule should be applied to short term capital gains and losses as against long term capital gains and losses. Trizec believes that there is a fundamental difference between the type of gains and losses that are made on a short term rollover and those gains and losses which are the result of a comparatively long term holding of capital assets, and Trizec suggests that this difference should be reflected by the imposition of ordinary income tax rates on short term capital gains and losses and a reduced rate of tax on long term gains and losses. Trizec has no strong views on what time period should be used to distinguish between a short term holding and a long term holding, but they do recommend in the interests of certainty that a fixed time period

be defined, even though, in some instances, this may result in somewhat arbitrary impositions. In the absence of any suggestions to the contrary, Trizec would support a one year period as being a reasonably satisfactory definition of a short term as against a long term holding period.

(iii) The tax rate applicable to short term gains and losses should be different from that applicable to long term gains and losses. As noted before, Trizec recommends that short term gains and losses be treated as ordinary income. All short term gains should be brought into income at ordinary rates, and all short term losses should be deductible in computing income. Trizec objects to the concept contained in Section 3.26 of the White Paper where particular assets will be subject fully to tax on gain, but are only contingently deductible if loss is suffered.

Insofar as long term gains and losses are concerned, Trizec feels that they should be treated separately and taxed at a rate not exceeding 25%. Trizec does not recommend that long term capital losses should be fully deductible from ordinary income, but it does recommend that long term capital losses be deductible to the extent of 50% in the computation of ordinary income. This latter provision, would, in terms of consistency, permit the offset of long term capital losses where long term capital gains were not available for direct offset.

(iv) Unrealized capital gains should not be taxed. Trizec recommends that the five year revaluation rule, the realization of gain on change of residence and the Section 3.41 realization of gain on gifts of appreciated assets be removed as being inconsistent with the general theory of Canadian tax law that a tax should only be paid when a profit is

actually realized.

i) Dividends - General

The ability of Trizec to make public issues of its shares in the future in comparison with other companies will be gravely affected by the proposed system for taxing corporate dividends. Under the White Paper, a dividend is more desirable from a company that pays high taxes than from a company that pays low taxes, whereas under the present law, all dividends from all Canadian companies that are subject to tax receive the same treatment, whether or not the declaring company pays high or low taxes. Since Trizec has a low creditable tax base because of capital cost allowances, its dividends will become much less attractive in the market place than the dividends of high tax paying companies.

Since in a successful real estate development company the reason for the non-payment of high taxes is because of a rapid expansion rate and the

creation of additional depreciable property, Trizec will be faced in this particular area with the result that if it continues its expansion potential so as to make its shares marketable, it will, at the same time, be creating a converse result of making its shares less desirable as potential dividend payers. The result of such a procedure will be either to militate against the declaration of dividends, or alternatively, to force retrenchment of expansion in order to make the dividends more desirable. Trizec submits that these regressive results should be avoided, since they will put too high a premium on solid, taxpaying, non-expansionist companies, as compared to courageous and expanding risk-taking companies.

j) Dividends - The Two and a Half Year Rule

Even for those companies who are full taxpayers and, therefore, would be capable of distributing tax free dividends, the proposals

of the White Paper would restrict the tax credit to taxes within the previous two and one half years (Section 4.27). No consideration has been given by the White Paper to the fact that the ability to declare dividends is often restricted by trust deeds and other contractual and economic commitments so that effectively, there will be no ability to declare the tax free dividend within the period in which such dividend would be tax free.

k) Dividends - Inter-company Distributions

A further area which will have a serious effect on companies such as Trizec is the application of the above dividend procedures to inter-corporate dividends. Since Trizec has multiple subsidiary companies, and is required so to do by reason of the nature of its business and current financing procedures, the passage of available funds

recommends that the Income Tax Act of Canada be amended to the following effect.

(i) No distinction should be made between WHC and CHC;

(ii) Companies should be entitled to file consolidated returns, consolidating elected controlled subsidiaries. Dividends from subsidiaries which have been so consolidated or on which the partnership election of Section 4.21 has been exercised should be tax free, but inter company dividends from other companies resident in Canada should be subjected to a flat tax of between 5% and 7½%.

m) <u>Consolidated Returns</u>

The failure of the White Paper to recommend the filing of consolidated returns will be a detriment to Trizec as well as to most corporate taxpayers in Canada. The operations of complex corporate structures in Canada has always resulted

in discrepancies within such structures, with various procedures being attempted in order to balance out profitable and losing companies within each group. This whole area of difficulty could have been avoided by provision for consolidated returns and the failure to make such a recommendation is not compensated by the partnership election provisions of Sections 4.19 to 4.23 of the White Paper. The reasoning of Section 5.22 of the White Paper is too restrictive, since the limitations of the partnership election are so stringent that on the basis of current business procedures, fewer and fewer of the subsidiary companies of companies such as Trizec will become eligible for such election. Even if we leave aside the necessity for attracting outside investors into the subsidiary company operations of Trizec, the growing tendency of mortgage lenders (both public and private) to demand a share participation as a bonus for their lending activity will eliminate the right

of partnership election for many of these subsidiary companies. Trizec recommends that the concept of consolidated returns be introduced into the law, since this is a system widely accepted for accounting purposes and in the tax rules of most foreign countries.

III. THE SPECIFIC APPLICATION TO TRIZEC OF SPECIFIC PROVISIONS

a) The Applicability of Section 5.17

Of primary importance to Trizec is whether or not the restrictive provisions of Section 5.17 of the White Paper will be applicable to real estate companies in general. Leaving aside other taxpayers for the moment, it is unclear whether a property development company will be entitled to deduct the loss on the operation of one property from a profit earned on another property. If this principle is, in fact, recommended by the White Paper, it seriously violates the basic principle of Canadian income tax law that each taxpayer is

required to pay tax on his net loss or gain in each year from all sources. The drafters of the White Paper seem to have come to the conclusion that any loss on property operations is somehow a contrived loss merely set up in order to deprive the Government of its proper tax receipts. Trizec respectfully submits to the Committee that there is no reason to treat real estate operations in any different manner from any other operations and that where, in fact, losses have been incurred pursuant to the Income Tax Act, they should be applicable against any other income of the taxpayer, particularly in those cases where the taxpayer is itself in the property business. The proposals of Section 5.17 restricting the deduction of losses created by capital cost allowance, interest and property taxes, seem unwarranted in the circumstances for all taxpayers in general and shows an unreasonable prejudice against a certain kind of activity in Canada.

b) Capital Cost Allowance - The Loophole Concept

The provisions of Section 5.17 of the White Paper insofar as they treat capital cost allowance, require a specific objection from Trizec. In the first place, the philosophy of this Section seems to be entirely wrong in that the use of depreciation against other income is treated as a "loophole" in the law. What is disregarded is that depreciation or capital cost allowance is no more than the writing off of an actual capital investment made by the taxpayer and the benefits which are deemed to be received through the loophole are, in fact, offset by the very large capital investment risk which has been taken by the investing taxpayer. As noted previously much investing in real estate is, by any test, a risk procedure and unless certain benefits are given to the investment as against an equivalent yield on say, Government Bonds, the investment will not be made. To deprive the real estate business in general of a flow of investment capital from individuals and corporations

not in the real estate business, because of the closing of this so-called loophole, will result on the one hand on the removal of a whole area of risk capital available for development of the country, while, at the same time, effectively creating a monopoly in the hands of the wealthy real estate developers who need not look for outside investment capital. This would appear to be an area where a sense of irritation at legal tax reduction has lead to a recommendation which has far reaching adverse effects far in excess of whatever benefits might be deemed to have been gained from the loophole closing.

c) Capital Cost Allowance - The $50,000 Rule

The final flourishing of the fear of real estate loopholes is to be found in the last suggested restriction contained in Section 5.17 of the White Paper, which would create a separate class of property for each rental building that costs $50,000 or more. Without taking into account any other forms of depreciable property in Canada, the

White Paper has singled out real estate for a particularly onerous restriction and has not even removed the restriction in respect of those companies, such as Trizec, who are themselves in the real estate business. There are compelling economic reasons why this proposal is ill founded. Firstly, the actual economic depreciation of each rental property does not occur at the same rate, and for various market and other economic reasons some properties depreciate in value while others appreciate in value. The thrust of the White Paper is that only buildings that have diminished in value can reasonably be sold without adverse tax consequences, with the result that there will be a tendency for the owners of existing profitable properties to hold them indefinitely and not to offer them on the market. It is obvious that any such restriction will serve to throttle the real estate development industry, since in the construction and property development fields while property may be primarily constructed or bought for investment

purposes, such property will not be so constructed or bought if it is made totally illiquid.

If Section 5.17 of the White Paper is to apply equally to all taxpayers, it will eliminate, as a practical matter, the concept of the property pool for depreciation purposes. Companies such as Trizec will, therefore, find themselves in the unfortunate position that any recapture of depreciation (and capital gains) will be immediately taxable upon realization, even though such company has losing assets on its books which cannot or should not be realized in order to offset the gain.

Trizec recommends that, at least insofar as companies engaged generally in the real estate business, the separate depreciation class that has to be created for each rental building which costs $50,000 or more be eliminated and that the pool concept of depreciable assets be continued. Trizec also suggests that such recommendation might go further so that capital gains and losses be equally

treated on a pool basis, since if income and capital gains are to be taxed at the same rate, it does not seem logical that a gain on sale should be divided between the element of recapture of depreciation and the element of capital gain profit.

d) Capital Cost Allowance - New Properties

Whatever the final results of the White Paper might be, Trizec suggests that the proposed procedures apply only to newly acquired properties. The whole corporate structure, cash flow, financing arrangements and other procedures of companies such as Trizec have over many years been adjusted to a system of law as presently in force. As a result of the existing legal rules a very high proportion of total income has been committed to meeting the expenses of operation, real estate taxes and interest on the funds borrowed for basic financing. The imposition of the new system on extant situations could result in serious, unfair and adverse consequences.

APPENDIX "B"

NAME: TRIZEC CORPORATION LTD.

SUBJECT: White Paper Proposals.

Analysis of Appendix "A" by Senior Advisor

This Brief is submitted by Trizec Corporation Ltd. a Canadian company incorporated in 1960 to develop and invest in real estate in Canada. The company has constructed properties costing in excess of $165 millions and has also acquired properties constructed by others. It now has a total investment of $226 millions in real estate.

The company is a widely held corporation and at least 54% of its common shares are owned by foreign investors.

Besides having given employment to many thousands during construction, the company employs about 2,000 people in the maintenance of its properties.

The Brief makes submissions upon four proposals contained in the White Paper. These are:

(1) Capital gains (Pages 15 to 37 of the Brief).

(2) Distribution of earnings (Pages 38 to 42 of the Brief).

(3) Consolidated returns (Pages 42 to 44 of the Brief).

(4) Property expenses and capital cost allowance. (Pages 44 to 50 of the Brief).

The Brief, in the Introduction (pages 8 to 11) sets out the company's reasons for making its submission and states its concern with the effects of the White Paper proposals under the following four categories:

1. "The effect on such taxpayers by virtue of the overall results which will arise under the White Paper legislation.

2. The effect on such taxpayers of particular legislation pursuant to the White Paper, which legislation will affect a large body of the taxpaying public and will have a serious effect on the taxpayers in question.

3. The effect on such taxpayers of particular legislation pursuant to the White Paper which has a more direct effect on the taxpayers in question than on most other groups of the taxpaying public.

4. The effect on such taxpayers of the effective retroactivity of legislation pursuant to the White Paper insofar as it affects prior investments and developments conceived pursuant to the prior law."

The Brief points out in pages 12 to 15, the serious adverse consequences which could result from a very substantial change to the general tax laws of Canada.

The attention of the Committee is drawn to the following comments.

1. "There can be little doubt that if all or substantially all of the White Paper is reflected in legislation, such legislation will be highly imperfect until, over a number of years, experience has shown whether the law has been properly and fairly drafted. During this period and as a result of the foregoing, there will be great uncertainty as to the actual effects of particular provisions, with the result that commerce in general will have a tendency to retrench due to this uncertainty." (Page 12 of the Brief)

2. "Even if the ultimate decision to legislate all or substantially all of the White Paper is accepted, not only the effect of such legislation but also the subject matter should be spread out over a number of years so as to gradually change the present income tax law to the desired new structure. This would have the advantage not only of giving a gradual testing period as to the effect of the new legislation, but also of building up a sufficient administrative cadre to properly administer the new legislation.' (Page 13 of the Brief).

3. "Even if only a small part of the proposals of the White Paper become law, the novelty of the procedures and the absence of any body of case law will make the decision making process a very risky matter for taxpayers. Under the present law, the growing complexity of the legislation and the varying applications of the existing provisions of the Income Tax Act, and particularly the tax avoidance sections, have already thrown a burden on taxpayers and tax advisers which it would be well to remove. Trizec, therefore, recommends that the Income Tax Act be amended so as to authorize the Department of National Revenue to issue binding rulings based on stated facts supplied by taxpayers to the Department. This legislation should be drafted in a way which will induce the Department to give such rulings, so that the understandable tendency of the Department not to prejudge will not overcome the obligation to issue such rulings in acceptable instances." (Pages 13 and 14 of the Brief).

4. "In the highly sensitive and complex economy of Canada the basic tax procedures of many years cannot be overturned and a whole new philosophy of taxation introduced without causing tremendous stresses in the commercial and financial community." (Page 14 of the Brief).

5. Speaking of the proposals to tax capital gains: "Trizec strongly recommends that Canada should not vote itself out of the international investing community by the procedure contemplated by the White Paper." (Page 16 of the Brief).

6. "There can be no question that if the capital gains tax is enacted in its proposed form, the future of real estate development will be very adversely affected." (Page 16 of the Brief).

7. "The White Paper states that most of the existing income tax treaties between Canada and foreign countries will be re-negotiated in order to eliminate the present protection given to foreigners against taxation of their capital gains in Canada. The Committee can easily envisage the reaction of existing foreign investors who over many years have placed substantial monies in Canada based on the reasonable assumption that they were protected both by Canadian law and by treaty provision from taxation on their ultimate capital gains. To retroactively change the status of these investors may be possible legally, but it can hardly give any confidence to future investors in the stability of the Canadian legal system and the continuity of our undertakings. This type of retroactive approach, while in the short run seemingly acceptable, cannot but seriously affect our stature in the international investing community." (Page 27 of the Brief).

8. "The ability of Trizec to make public issues of its shares in the future in comparison with other companies will be gravely affected by the proposed system for taxing corporate dividends." (Page 38 of the Brief).

9. Speaking of the 2½ year rule.

"No consideration has been given by the White Paper to the fact that the ability to declare dividends is often restricted by trust deeds and other contractual and economic commitments so that effectively, there will be no ability to declare the tax free dividend within the period in which such dividend would be tax free." (Page 40 of the Brief).

10. Speaking of consolidated returns:

"This whole area of difficulty could have been avoided by provision for consolidated returns and the failure to make such a recommendation is not

compensated by the partnership election provisions of Sections 4.19 to 4.23 of the White Paper. The reasoning of Section 5.22 of the White Paper is too restrictive, since the limitations of the partnership election are so stringent that on the basis of current business procedures, fewer and fewer of the subsidiary companies of companies such as Trizec will become eligible for such election." (Page 43 of the Brief).

The Brief makes the following suggestions respecting:

(1) Capital gains:

(a) The Income Tax Act should be amended to define capital gains. (Pages 34 and 35 of the Brief).

(b) A different rule should be applied to short term capital gains and losses as against long term capital gains and losses. (Pages 35 and 36 of the Brief).

(c) The tax rate applicable to short term gains and losses should be different from that applicable to long term gains and losses. (Pages 36 and 37 of the Brief).

(d) Unrealized capital gains should not be taxed. (Pages 37 and 38 of the Brief).

(2) Distribution of Earnings (dividends).

(a) No distinction should be made between Widely Held Corporations and Closely Held Corporations. (Page 42 of the Brief).

(b) Companies should be entitled to file consolidated returns for elected controlled subsidiaries. (Page 42 of the Brief).

(c) Dividends from companies which have been consolidated or which have elected to be taxed as partnerships should be tax free. (Page 42 of the Brief).

(d) Intercompany dividends from other companies resident in Canada should be subjected to a flat tax of between 5% and 7½%. (Page 42 of the Brief).

(3) Consolidated returns.

"Trizec recommends that the concept of consolidated returns be introduced into the law, since this is a system widely accepted for accounting purposes and in the tax rules of most foreign countries." (Page 44 of the Brief).

(4) Property expenses and capital cost allowance.

(a) "Trizec recommends that, at least insofar as companies engaged generally in the real estate business, the separate depreciation class that has to be created for each rental building which costs $50,000 or more be eliminated and that the pool concept of depreciable assets be continued." (Page 49 of the Brief).

(b) "Trizec also suggests that such recommendation might go further so that capital gains and losses be equally treated on a pool basis, since if income and capital gains are to be taxed at the same rate, it does not seem logical that a gain on sale should be divided between the element of recapture of depreciation and the element of capital gain profit." (Pages 49 and 50 of the Brief).

(c) "Whatever the final results of the White Paper might be, Trizec suggests that the proposed procedures apply only to newly acquired properties." (Page 50 of the Brief).

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: Trizec Corporation Ltd.

Principal Subject: Capital Gains
(a) General

Present Tax Law	White Paper Proposals	Principal Points of Brief
Not Applicable	Capital Gains proposals are contained in Chapter 3 of the White Paper.	Page 15 of the Brief The Brief points out: In almost every Western country and in the United States in particular, the taxing systems have always acknowledged the merit of applying different taxing procedures to current income receipts and capital appreciation or depreciation. The divergence of the White Paper on this subject can only reduce the funds available for the expansion of Canadian development.

Name: Trizec Corporation Ltd.

Principal Subject: Capital Gains
(b) Valuation day

Present Tax Law	White Paper Proposals	Principal Points of Brief
Not applicable	Capital gains proposals are contained in Chapter 3 of the White Paper.	Page 19 of the Brief: The Brief submits "that all assets on valuation date be given a cost basis for capital gains tax equal to the higher of their historical cost or value, with no capital gain or loss being recognized until historical cost is achieved."

Name: **Trizec Corporation Ltd.**

Principal Subject: Capital Gains.
(c) Widely held corporation, Closely held corporation, 5 year revaluation rule

Present Tax Law	White Paper Proposals	Principal Points of Brief
Not applicable.	Capital gains proposals are contained in Chapter 3 of the White Paper.	Pages 19 and 20 of the Brief The Brief makes the point that: "Notwithstanding the fact that Trizec is a widely held Canadian corporation (WHC), and will by definition benefit from the lower capital gains tax on its shares, it opposes the distinction between WHC and closely held Canadian corporations (CHC), the failure to differentiate between short term and long term capital gains at different tax rates, and the five year revaluation rule of Section 3.33 et seq. Whatever tax benefits Trizec and other WHC might obtain by virtue of the advantages to their shareholders on both capital gains and dividends, Trizec feels that

Name: Trizec Corporation Ltd.

Principal Subject: (c) Widely held corporation, Closely held corporation, 5 year revaluation rule.

Present Tax Law	White Paper Proposals	Principal Points of Brief
		the imposition of more onerous rules on CHC and unincorporated businesses, and particularly more onerous capital gains provisions, is not something which it can support because of the general overall detriment to small business and the economy." Pages 22 and 23 of the Brief "In summary, therefore, Trizec opposes the artificial distinction between WHC and CHC and the different tax effects given to capital gains, capital losses and dividends on their respective shares, since (i) the distinction and the reasons as to why any given company is publicly held or not publicly held are not the proper basis for different treatment,

Name: **Trizec Corporation Ltd.**

Principal Subject: Capital Gains.
(c) Widely held corporation, Closely held corporation, 5 year revaluation rule.

Present Tax Law	White Paper Proposals	Principal Points of Brief
		(ii) most small business and real estate development is done by CHC or unincorporated business and should not suffer a higher rate of capital gains tax than shares of publicly held and normally larger and wealthier companies, (iii) to give a benefit to the stock trader in shares of WHC who normally contributes nothing to the operations of the WHC as against the working individual who operates his own business, directly or through a CHC, violates the general concept of reform set forth in the White Paper."

Name: Trizec Corporation Ltd.

Principal Subject: Capital Gains
(c) Widely held corporation, Closely held corporation, 5 year revaluation rule.

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Page 23 of the Brief "Trizec, therefore, recommends that following the tradition of all other countries imposing capital gains tax, no distinction be made between types of business assets and snares in imposing the tax, but that a differentiation be made between gains realized on the short term turnover and those developed over a longer period.

Name: Trizec Corporation Ltd.,

Principal Subject: Capital gains.
(d) Deemed -realization on leaving Canada

Present Tax Law	White Paper Proposals	Principal Points of Brief
Not applicable	Capital gains proposals are contained in Chapter 3 of the White Paper.	Pages 23 and 24 of the Brief "The imposition of the rule of Section 3.40 of the White Paper would, in the opinion of Trizec, substantially reduce the inter-flow of Canadians and foreigners and the resultant educational and experience benefits obtained for this country as a result thereof."

Name: Trizec Corporation Ltd.

Principal Subject: Capital Gains.
(e) The Foreign investor.

Present Tax Law	White Paper Proposals	Principal Points of Brief
Not applicable	Capital gains proposals are contained in Chapter 3 of the White Paper and in so far as these proposals affect non residents of Canada paragraphs 6.43 to 6.47 of Chapter 6 of the White Paper.	Page 24 of the Brief "The taxing of capital gains of non-resident shareholders does not accord with the principles and practices of virtually all western countries." Page 25 of the Brief: (1) "Only West Germany and the Netherlands attempt to impose such a tax (with, we understand, something less than complete success) and neither the United States nor the United Kingdom imposes such a tax."

Name: Trizec Corporation Ltd.

Principal Subject: Capital Gains.
(e) The Foreign investor.

Present Tax Law	White Paper Proposals	Principal Points of Brief
		(2) "The OECD Model Treaty (accepted by Canada) does not permit the imposition of such a tax and, in any event, through the use of bearer shares or unrecorded transfers it is apparent that a substantial number of the transactions in question will not be reported and will not be enforceable as a matter of international tax law."
		(3) "Trizec is of the opinion that in the competitive search for foreign capital investment, Canada cannot afford the luxury of imposing such a tax which the United States, for instance, does not impose."

Name: Trizec Corporation Ltd.

Principal Subject: Capital Gains
(f) Adjustment of cost basis.

Present Tax Law	White Paper Proposals	Principal Points of Brief
Not applicable	Capital gains proposals are contained in Chapter 3 of the White Paper.	Pages 28 to 30 of the Brief The Brief comments upon the lack of information in the White Paper as to the Treatment to be afforded to interest and points out some of the difficulties that will be created.

Name: Trizec Corporation Ltd.

Principal Subject: Capital Gains
(g) Tax free reorganizations

Present Tax Law	White Paper Proposals	Principal Points of Brief
Not applicable	Capital gains proposals are contained in Chapter 3 of the White Paper.	Pages 31 to 32 of the Brief The Brief points out that the proposals remove from the "rollover" provisions many transactions normally encountered in a complex society. It makes the following points: (1) "In explaining the exclusion of widely held corporations from the ambit of most rollover provisions the White Paper gives as the reason for this that "the provisions necessary to achieve the proper ultimate result would be too complex". Is it, therefore, the attitude of the White Paper to introduce a highly complex taxation system, and then to avoid equitable relief in favour of the taxpayers on the grounds that it is too complex?"

Name: Trizec Corporation Ltd.

Principal Subject: Capital Gains
(g) Tax free reorganizations.

Present Tax Law	White Paper Proposals	Principal Points of Brief
		(2) "The administration convenience, therefore, of the White Paper is to seriously affect the chances of a CHC to sell out their holdings to public companies thereby excluding from the commerce of our country a whole vast area of normal and proper business transactions."

Name: Trizec Corporation Ltd.

Principal Subject: Capital Cost Allowance
Segregation of common assets into separate pools

Present Tax Law	White Paper Proposals	Principal Points of Brief
Part XI of the Income Tax Regulations makes no provision for the segregation of assets which fall into a specified class in separate classes if the asset cost more than a certain sum. There is however a specific exception to this in the case of ships.	5.17 The government proposes to close this loophole in three ways. First, as mentioned in Chapter 3, a person who inherits property would for tax purposes inherit the tax cost of that property to the deceased. In this case, that would mean that the inheritor starts with the same base for depreciation as the deceased had when he died. Second, a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance. (It is also proposed that the same restriction be placed on the deductibility of losses arising from holding property if those losses are created by a deduction of interest or property taxes. Otherwise taxpayers could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property.) Finally, it is proposed that a separate depreciation class be created for each rental building that costs $50,000 or more. This would mean that there would be a day of reckoning for the owner of each large building. As each such building is sold the taxpayer would bring back into income the amount by which depreciation deducted for tax purposes exceeds the depreciation actually suffered, or conversely he would get a deduction for tax puposes immediately if he has in fact suffered greater depreciation than he has been allowed for tax purposes.	Page 45 of the Brief The Brief makes the points that: (1) "The drafters of the White Paper seem to have come to the conclusion that any loss on property operations is somehow a contrived loss merely set up in order to deprive the Government of its proper tax receipts." (2) "The proposals of Section 5.17 restricting the deduction of losses created by capital cost allowance, interest and property taxes, seem unwarranted in the circumstances for all taxpayers in general and shows an unreasonable prejudice against a certain kind of activity in Canada."

Name: Trizec Corporation Ltd.

Principal Subject: Capital Cost Allowance
Segregation of common assets into separate pools.

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Page 46 of the Brief (3) "the philosophy of this Section seems to be entirely wrong in that the use of depreciation against other income is treated as a "loophole" in the law." And on pages 47 and 48 (4) " Without taking into account any er forms of depreciable property in Canada, the White Paper has singled out real estate for a particularly onerous restriction and has not even removed the restriction in respect of those companies, such as Trizec, who are themselves in the real estate business."

Name: Trizec Corporation Ltd.

Principal Subject:

Present Tax Law	White Paper Proposals	Principal Points of Brief
		and on page 49 (5) "If Section 5.17 of the White Paper is to apply equally to all taxpayers, it will eliminate, as a practical matter, the concept of the property pool for depreciation purposes."

APPENDIX "C"

Nova Scotia Fruit Growers' Association

ORGANIZED 1863

SUBMISSION ON TAXATION POLICY

TO THE

SENATE COMMITTEE ON BANKING,

TRADE & COMMERCE

1. The Nova Scotia Fruit Growers endorse the principal of taxation of actual income and the ability to pay.

2. We suggest that the present municipal and provincial tax system combined with the "White Paper" proposals could cause additional taxation for fruit growers, even though their income or ability to pay has not increased.

3. Fruit growing requires large capital investment in orchards, buildings and equipment. Municipal taxes are based on investment in real property and are used largely for the education of all young people in our country. A person with a large portfolio of stocks and bonds and professional income, living in a rented house, contributes very little to this fund. The investment of capital in land and buildings and the consequent commitment of this capital for many years to come forms the backbone of our municipalities, provinces and Canada as a nation. Capital committed in this manner cannot be converted, shifted or manipulated according to changes on the stock market, increase of interest rates, inflation or any other changes on the capital market, government induced or otherwise.

4. The return on investment capital in agriculture as a rule is small. Due to the nature and the firm commitment

of capital in agriculture it is practically impossible for farmers to obtain capital on the open market. This situation forces a farmer to invest and continuously re-invest all his money to be able to continue his operation.

5. A farmer is not able to convert part of his yearly earnings into other investments or savings. For his retirement he will be entirely dependent on the sale of his farm. Having re-invested all his earnings in the farm, the sales price includes his life-time savings, if any.

6. Income Tax.

The new income tax proposals will reduce the tax for lower income farmers. According to the White Paper, pages 30, 31, 32, maximum tax savings will be:

Single	$ 52. - at $1600. - income before deductions
Married, no dep.	$111. - at $3000. - income before deductions
Married, 2 dep.	$118. - at $3500. - income before deductions

However, the new tax scale will increase sharply up to 51.2% for incomes of $24,000.00 and over. This increased tax rate will become of great significance to a farmer when he sells his farm.

7. During the year of sale, a farmer will have income from the sale of last year's crop but he will not have

growing expenses for the new crop. Under the present system these receipts are taxable income. In effect, however, a good portion of this income is operating capital which is returned to the operator. This operating capital has been invested by the farmer over the years from tax paid earnings. Our present accounting system does not show operating capital as a capital liability to be re-captured tax free when the farm operation is discontinued. In fact, to a large portion, this investment is double taxed. This problem exists now but will become considerably more important under the proposed new system.

8. Capital Gains.

Inflation is of minor importance to investments in stocks which can be sold and traded in short intervals. Farm investment is a life-time investment and subject to inflation without offering the owner any opportunity to adjust to changes, in other words, completely passive. Inflation has become a fact of life (4.4% in 1969) and over the years farm properties will be affected. Inflation does not increase purchase power and the ability to pay taxes. The proposed system whereby inflation accumulated over one or even two generations will be added on top of an annual income and fully taxed, does not tax

income but requires a person to pay part of his inflated original capital to the government.

9. The exemption proposed for home owners is intended to largely exempt housing from capital gains tax. The amount of $1150.00 is not adequate to put a farmer on an equal footing with other tax payers. It also will only be available to him if he sells his house with the farm. The sale of land or buildings, or the farm without the farm house would attract capital gains tax on the full amount of inflation. The proposal also does not seem to consider a farmer's house which is not located on the farm itself as part of his farm.

10. The proposal to fix a v-day value as basis for taxation which could occur 10, 30 or even 60 years from now without annual adjustment of v-day values, would in effect, as inflation progresses, establish an ever increasing liability for the farmer. This will become so large that it could impair his borrowing capacity and a sale of the farm could result in a considerable loss of purchase power compared to v-day values.

11. A closer definition of capital gains has to be found. Orchardists are concerned about how annual re-investment

of capital can be shown for capital gains tax purposes. The planting and maintenance of young orchard requires considerable amounts of money before a harvest can be expected. These expenses are now deductible for income tax purposes. The new capital gains tax presents a special problem as shown below (all figures are fictitious):

50 ac. land on v-day	at $100.00 ac.	$ 5,000.00
planting & maintenance of orchard for 10 years	at $400.00 ac.	$20,000.00
		$25,000.00
sale due to sickness of owner 10 years after planting	at $400.00 ac.	$20,000.00
loss due to sale		$ 5,000.00
sales price		$20,000.00
less v-day value		$ 5,000.00
capital gains to be added to other income		$15,000.00

This example shows that even though the owner has absorbed a loss of $5,000.00 when he sold his orchard he will have to pay capital gains tax on $15,000.00.

Having deducted the total investment of $20,000.00 as operating expense over the run of 10 years, the farmer has realized some income tax savings, which however are only a small part of the $20,000.00. The far larger portion represents capital investment and for capital gains tax purposes should be added to the v-day value in addition to inflation adjust-

ments.

12. Retirement Fund.

Many Canadian taxpayers have the opportunity to invest part of their income in retirement funds and obtain tax savings. Farmers are forced to re-invest earnings in their farm due to lack of sufficient loan capital available on the open market. Farmers should be given equal tax advantages as well as other payers. The revenue from the sale of their farm has always been their retirement fund.

13. Tenant Houses.

Many farmers have to maintain several tenant houses for their employees. These houses, considering the rent which a farm worker can pay, produce very little income, usually a loss, but they are a necessary evil. The houses are not always located on the farm itself. Provisions have to be made to the effect that these houses are considered part of the farm and that losses can be deducted from other farm income.

14. The White Paper suggests that the government will not be involved in establishing v-day values, but reserve the right to dispute the original v-day value set by the farmer, when he sells all or part of his property.

The Fruit Growers feel that it would be extremely difficult to assess any type of farm property, in particular orchard or a herd of cattle, etc. retroactively after several years have passed. We further suggest that if the government wishes to exercise its right to dispute v-day values set by individuals (and we believe it should do so in fairness to all), it should do so within 12 months after v-day., The government should also set guidelines for evaluation which are very clear and which do not force the farmer to pay for outside appraisals. Ground rules for a dispute by the government have to be established and also how the costs of such a dispute will be shared.

15. In summing up, the Nova Scotia Fruit Growers suggest:

1) Municipal taxes to be considered part of the total tax burden carried by a farmer. Annual payments to be added to v-day values.
2) Farm accounting method to include annual statement of invested operating capital to be re-captured tax free after farm has been sold.
3) V-day values to be increased annually to adjust for inflation. Rate to be set by the government each year.
4) Farmers permitted to increase his v-day value annually by the true amount of additional capital

invested.

5) Part of a farmer's annual re-investment in a farm to be treated as retirement fund contribution.

6) Tenant houses, regardless of their location to be part of the farm unit. Operating losses deductible from other farm income.

7) To permit a farmer to make financial arrangements for the future, the government to commit itself to v-day values set by owners within a period of 12 months after v-day.

This submission by the Nova Scotia Fruit Growers' Association is intended to support and may be supplemented by submissions made by other farm organizations. If there are views expressed in this paper which are in opposition to suggestions advanced by others on behalf of Canadian farmers this will demonstrate to our Government the complexity of the new White Paper proposals.

Respectfully submitted,

Nova Scotia Fruit Growers' Association

Kentville, Nova Scotia
March 12, 1970
/dml

APPENDIX "D"

THE CANADIAN MEDICAL ASSOCIATION

SUBMISSION

TO THE

STANDING SENATE COMMITTEE ON BANKING,

TRADE AND COMMERCE

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APPENDIX PRESENTED BY: THE ASSOCIATION OF CANADIAN MEDICAL COLLEGES
THE CANADIAN MEDICAL ASSOCIATION
THE CANADIAN ASSOCIATION FOR CONTINUING MEDICAL EDUCATION
THE COLLEGE OF FAMILY PHYSICIANS OF CANADA
THE ROYAL COLLEGE OF PHYSICIANS AND SURGEONS OF CANADA

SUMMARY OF THE SUBMISSION

OF

THE CANADIAN MEDICAL ASSOCIATION

TO THE

STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

The Canadian Medical Association speaks on behalf of the medical profession of Canada. We feel compelled to comment on the impact of the White Paper proposals because they affect not only every doctor practising in Canada, but future generations of doctors as well. Our primary concern with these significant tax changes is the effect they will have on present and future medical manpower. We are very much aware of the mobility of doctors and extremely concerned that in addition to the need to retain our present complement, we require a substantial and continuing inflow of immigrant physicians to provide medical services for Canadians. Tax changes, which appear to selectively discriminate against the middle and upper-middle income groups, could materially reduce the number of doctor immigrants and could adversely influence the existing emigration rate of Canadian medical graduates. At any one time more than 700 of our graduates are undergoing further training in hospitals in the United States. This group is extremely susceptible to the difference in opportunity between the two countries. Any measures that tend to widen the discrepancy cannot help but prejudice the efforts that are now being made to ensure that these doctors ultimately return to Canada.

Recommendation 1 - Tax Rates - Pages 1-6

We recommend that the proposed income tax rate structure be re-examined in conjunction with the revenue yields projected by the government, with a view to alleviating the income tax burden on middle and upper-middle income taxpayers.

Recommendation 2 - Capital Gains - Pages 6-7

We recommend that taxes on capital gains should only be levied when the gain is realized on the sale of the investment or commodity, and that consideration be given to a reduction in the proposed rates of tax for capital gains.

Recommendation 3(a) - Capital Gains - Principal Residences
Pages 7-10

The Association recommends that a capital gain realized on the sale of a principal residence should be exempt from tax.

Recommendation 3(b)

If, however, capital gains on a residence are to be recognized,

a) Taxpayers should be allowed to determine the gain on a sale for tax purposes based on the greater of the cost of the residence or its value on 'valuation day'.

b) A capital loss on the sale of the principal residence should be allowed as a deduction from income.

c) The proposed 'rollover' provision should be extended to cover all changes of residence.

d) The annual exemption allowance of $1,000 per year of occupancy should be replaced by a percentage (approximately 4-5%) of the cost, sufficient to offset the effect of inflation.

Recommendation 4 - Basis of Accounting - Pages 10-11

We recommend that the existing provisions of the Act regarding the cash basis of reporting income for certain taxpayers be retained and that doctors and other professional taxpayers be allowed to use either a cash or an accrual method of computing income.

Recommendation 5 - Gifts - Page 12

The Association recommends that a 'rollover' provision be introduced similar to that proposed for estate purposes whereby the wife would be deemed to have acquired property gifted by the husband at its cost to the donor. Such a provision would prevent tax being levied on unrealized gains by postponing such tax until the property was disposed of by the wife and could be so arranged that there would be no loss of tax revenue.

Recommendation 6 - Sale of Depreciable Property by An Estate - Page 13

We recommend that estate taxes and succession duties paid on the recapture of depreciation be allowed as a deduction from the proceeds of a subsequent sale of the relevant depreciable assets.

Recommendation 7 - Estate Taxes - Pages 13-14

The Association recommends that the rates of estate tax be substantially reduced or that the estate tax be phased out over a period of years as the tax on capital gains fully matures.

Recommendation 8 - Income Averaging - Pages 14-16

We recommend that all taxpayers be permitted to average their incomes on a basis similar to that now provided in the present Income Tax Act for Farmers and Fishermen.

Recommendation 9 - Fellowships, Scholarships, Bursaries - Pages 16-18

The Association recommends that fellowships, scholarships, bursaries, and research grants not related to service, should not be included in the income base of a taxpayer.

Recommendation 10 - Taxation of Associations' Investment Income Page 17

We recommend that the investments of non-profit organizations such as the Canadian Medical Association should not be subject to tax.

Recommendation 11 - Automobile Expenses - Pages 18-19

We recommend that an amendment be made to the Income Tax Act which would distinguish between situations wherein an over-riding necessity for the property is inherent because of the nature of the taxpayer's business, and other situations where the use of the property is ancillary to the business. If the property was deemed to be a necessary and an integral part of the taxpayer's business, we recommend that the full amount of the costs should be used to determine capital cost allowances as other use would be sporadic or occasional. If, however, the property has an ancillary use only, the allocation should be made on the basis now set out in Section 20(6)(e).

Recommendation 12 - Registered Retirement Savings Plans - Pages 19-22

The Association's recommendations concerning registered retirement savings plans are as follows:

a) That the present maximum contribution of $2,500 be increased to $3,500 and that the maximum contribution for salaried taxpayers be increased proportionately.

b) That taxpayers over 50 years of age be allowed a deduction of twice the normal maximum amount allowable.

c) That maximum allowable contributions be adjusted periodically to reflect changes in the purchasing power of the dollar.

d) That the present provisions of the Act relating to the taxation of lump sum withdrawals and death benefits from registered retirement savings plans be retained.

e) That the proposed restriction on foreign investment by registered retirement savings plans of 10% of their assets be withdrawn, or that this limit be increased to a figure higher than 10%.

Recommendation 13 - Conventions - Pages 22-24

We strongly recommend that the expenses of attending bona fide conventions should be continued as a business expense.

COURSES IN CONTINUING MEDICAL EDUCATION - Pages 24-32

Attached to this brief as an Appendix is a proposal presented jointly by the medical organizations in Canada which have a major

interest in continuing medical education. The Canadian Medical Association is one of the participants in this joint brief and wholeheartedly supports the recommendations which will be made to this Committee.

Recommendation 14

We recommend that our proposals regarding costs of continuing medical education, as set out in the appended joint submission, should be adopted.

MR. CHAIRMAN AND MEMBERS OF THE STANDING SENATE COMMITTEE
ON BANKING, TRADE AND COMMERCE

Introduction

This constitutes a submission from the Canadian Medical Association, a national organization of physicians founded in 1867, whose membership comprises more than 21,000 of the 26,000+ doctors in Canada. We undertake to speak on behalf of Canada's doctors. We are fully aware of the importance of the study which you are undertaking and we appreciate the opportunity provided to us to make our views known. These views relate both to the Proposals for Tax Reform where the interest of doctors are directly or indirectly affected and to other taxation considerations where the White Paper is silent.

The Canadian Medical Association has followed with interest the various studies of our tax system which have preceded these proposals. We have made a public submission to the Royal Commission on Taxation and we have made a number of private submissions to the Minister of Finance. Some of our opinions are of long standing. Others are directly attributable to the proposals contained in the White Paper. Our comments and recommendations result from a consensus established from correspondence with many individual physicians and provincial and local study committees which were specially formed for this purpose.

Potential Loss of Physicians to the United States

We feel compelled to comment on the impact of the White Paper proposals because they affect not only every doctor practising in Canada, but future generations of doctors as well. Our primary

concern with these significant tax changes is the effect they will have on present and future medical manpower. We are very much aware of the mobility of doctors and extremely concerned that in addition to the need to retain our present complement, we require a substantial and continuing inflow of immigrant physicians to provide medical services for Canadians. Tax changes, which appear to selectively discriminate against the middle and upper-middle income groups, could materially reduce the number of doctor immigrants and could adversely influence the existing emigration rate of Canadian medical graduates. At any one time more than 700 of our graduates are undergoing further training in hospitals in the United States. This group is extremely susceptible to the difference in opportunity between the two countries. Any measures that tend to widen the discrepancy cannot help but prejudice the efforts that are now being made to ensure that these doctors ultimately return to Canada.

Tax Rates and Burdens

We are pleased that the White Paper proposals will increase basic exemptions and will free an estimated 750,000 low income Canadians from paying income tax. We realize that this revenue loss will have to be borne by other Canadians. We believe, however, that this increased requirement should be assumed by all other taxpayers or by the increased income from the proposed tax on capital gains, rather than by an undue tax emphasis on the middle and upper-middle income group.

It had been our belief that the introduction of a tax on capital gains would have the effect of reducing taxes on the earned income of those Canadian taxpayers who have in the past borne the brunt of our income tax system. Most Canadian doctors earn between $18,000 and $40,000 per year of fully-taxed income. We have a relatively short lifetime earnings period with income peaks which attract disproportionately high marginal tax rates. We must class as inequitable any proposal which under the guise of tax reform has the effect of increasing the present tax paid on earned income.

Part of this adverse effect on middle and upper-middle incomes arises from questionable basic assumptions contained in the White Paper. The Minister of Finance has stated that his proposals are designed to collect approximately the same amount of tax in the first year under the proposed new system as would have been collected if the present system would have continued in effect. In his estimates, the Minister does not appear to have made allowances for the increase in tax revenue which will arise from anticipated increases in Canada's Gross National Product due to inflation and productivity gains. The Minister does indicate that the amount of revenue produced under the new system will be 5% higher in the fifth year than in the first year, but it appears that this eventual increase will be considerably greater. While we recognize that current fiscal policy demands a surplus to combat inflation, we find it difficult to equate his assumptions for continuing future revenue requirements with the conclusions of other published

studies which suggest that demands on federal revenues are declining in proportion to other levels of government. We also note that current studies of the White Paper proposals, particularly those undertaken by the Province of Ontario, suggest that the net increase in revenue will be substantially in excess of the Minister's projections. If this proves to be correct it follows that the use of these understated revenue projections will prevent a proper analysis of existing tax loads which in our opinion should allow a substantial reduction in tax on basic income for the middle and upper-middle income groups.

Taxes must be fair and equity must be apparent. Increased taxes for the aforementioned income groups, which include our most productive citizens, will bring about individual re-examination of income, status and the contribution which individuals can make in Canada. Substantial differences in taxation could increase emigration to the United States. We of course are very much aware of the mobility of doctors and we would point out that our present minimal emigration problem is due in large part to the existence of the war in Viet Nam, the United States draft laws and recent urban disturbances in the United States. Any easement of these United States problems could result in substantial emigration by members of the professions and management personnel, if the Government of Canada pursues a policy which increases the disparity in income tax.

The following table [I] illustrates the disparities between the American and Canadian taxpayer at various levels of income which a doctor could be expected to earn:

Net Income	Canadian Federal & Ontario Income Taxes	U.S. Federal & State Income Taxes — Resident of: New York	Ohio
$20,000	$ 5,262	$3,002	$2,480
25,000	7,434	4,274	3,488
40,000	14,711	9,819	8,039

It might be useful to the Committee to emphasize these disparities by the use of a hypothetical situation. Let us consider the status of an experienced doctor in Canada who earns $40,000 per year and emigrates to the State of Ohio at age 40. If we assume that he earns the same income in the United States and subsequently retires at age 65, he will have paid an aggregate of $166,800 less in income taxes than he would have paid in Canada over the same period. The difference in after-tax accumulation assumes even more astronomical proportions if we take into consideration that a doctor in the United States earns more than his counterpart in Canada.

[I] The calculations of tax have been based on the following assumptions:

a) Proposals contained in the White Paper and the U.S. Tax Reform Bill have been fully implemented.

b) The taxpayer is a married homeowner with two dependent children under age 16.

c) Canada Pension Plan and United States F.I.C.A. contributions have been excluded from calculations.

d) Average itemized deductions claimed by taxpayers at each income level have been used in lieu of standard deductions. These average deductions were obtained from 1967 taxation statistics published by the Canadian and United States taxation authorities.

e) The exchange difference between the Canadian and U.S. dollar has been taken into consideration.

Recommendation 1

We recommend that the proposed income tax rate structure be re-examined in conjunction with the revenue yields projected by the government, with a view to alleviating the income tax burden on middle and upper-middle income taxpayers.

Capital Gains

Some doctors disagree with the concept of including capital gains in their income base, but most physicians who have written to us have suggested that capital gains should be subject to taxation in some form. Doctors earn almost all their income from professional fees or salaries. They earn good incomes but work much longer hours and are subject to more responsibility than most other Canadian workers. Moreover, they have been denied the current tax benefits of incorporation. Doctors have no access to stock options or to so-called expense account living. It is predictable, therefore, that the medical profession in principle should favour the broadening of the tax base to include capital gains.

We do not propose to comment on the detailed application of taxes to different kinds of capital gains but we feel very strongly that taxes should only be paid when the gain is realized on the sale of the investment or commodity. We are also concerned that the proposed tax rates are too high and that they should be reduced so that they are at comparable levels with other countries.

The proposed five year revaluation of investments in widely-held Canadian companies and the requirement that taxes be paid on

paper profits may adversely affect many taxpayers. Of particular concern is the reduced profit on investments caused by forced realization. The cumulative effect of these taxes could exceed the amount of capital gains tax on other types of investments and thus reduce the effectiveness of Canadian stocks as long-term investments.

Recommendation 2:

We recommend that taxes on capital gains should only be levied when the gain is realized on the sale of the investment or commodity and that consideration should be given to a reduction in the proposed rates of tax on capital gains.

Capital Gains - Principal Residences

The White Paper sets out very detailed proposals providing offsetting exemptions to any capital gains realized on the sale of a principal residence with the intent that capital gains should not apply on most transactions. The rationale seems to be that a combination of allowed expenses and exempted gains would completely offset increases in value due to inflation and scarcity based on the current value of the average Canadian home. However, we suggest that it is unlikely that the proposed allowances will be high enough to offset the effect of inflation. It seems to us that the government's objective could be more easily accomplished simply by exempting from income tax any gain realized by a taxpayer on the sale of his principal residence.

If, however, it is the intention of government to tax capital gains on principal residences, adequate allowance must be made

to offset the effect of inflation. The proposed $1,000 annual allowance is equal to approximately 4% - 5% of the value of the average home in Canada. This standard percentage of cost for each year of occupancy should apply as an exemption on the sale of all principal residences without any maximum limit.

A taxpayer residing in an area where real estate values are depressed on 'valuation day' could later realize a taxable capital gain which would actually include a recovery of his original cost. For example, suppose a taxpayer's principal residence was acquired by him at a cost of $45,000, that its fair market value on 'valuation day' was $35,000, and that he sold it five years later for $50,000. The amount included in his taxable income would be:

Proceeds of Sale		$50,000
Value on 'Valuation Day'	$35,000	
Total of Proposed Allowances - 5 x $1,150	5,750	40,750
Taxable Capital Gain		$ 9,250

Although the taxpayer's actual gain is only $5,000, which would normally have been reduced to nil by the annual allowances, he is rendered liable to income tax on $9,250 because of the arbitary valuation rules.

If the government intends to tax capital gains, it must be prepared to allow capital losses in respect of comparable property. One important item which is not given sufficient consideration in the White Paper proposals is the application of capital losses to the taxpayer's principal residence.

It is our belief that capital losses on the sale of principal residences may occur infrequently but we would point out that such losses might have a disastrous effect on the individuals concerned when they do occur. While most capital losses will result from production changes by large business enterprises, doctors can incur substantial capital losses on the sale of their homes, particularly in smaller communities. A doctor leaving a small community may not be able to find a willing buyer. Failure to allow a resultant capital loss is an inequity which will tend to reduce the mobility of the profession.

We also believe that the 'rollover' provisions are too restrictive. These provisions would allow a taxpayer, who is changing his residence because a change of job requires him to move to a new area, to reduce the cost of his new residence by the amount of any profit which would otherwise be taxable on the sale of his own residence. This 'rollover' will, of course, increase by an equal amount the profit on the ultimate disposal of his new residence.

This proposal assumes that only a change of residence resulting from a change of job is legitimate. It fails to recognize that taxpayers change residences for a number of other legitimate reasons, such as a need for a larger house because of an increase in the size of a family or simply because of a desire to locate in a different neighbourhood. This omission is neither consistent nor equitable.

Recommendation 3(a)

The Association recommends that a capital gain realized on the sale of a principal residence should be exempt from tax.

Recommendation 3(b)

If, however, capital gains on a residence are to be recognized:

a) Taxpayers should be allowed to determine the gain on a sale for tax purposes based on the greater of the cost of the residence or its value on 'Valuation Day'.

b) A capital loss on the sale of the principal residence should be allowed as a deduction from income.

c) The proposed 'rollover' provision should be extended to cover all changes of residence.

d) The annual exemption allowance of $1,000 per year of occupancy should be replaced by a percentage (approximately 4% - 5%) of the cost, sufficient to offset the effect of inflation.

Basis of Accounting

Doctors like other professional persons have been allowed a choice of cash or accrual methods of computing income. Most doctors use a cash system because it suits the payment methods used by individuals and insuring agencies. The introduction of medicare, and the regulations of their administering agencies outlawing payment of outdated accounts, reduces the potential for postponing income. Very few doctors have inventories and where no physical inventories

are involved, the cash and accrual bases yield the same net result over a period of time, and there is no actual loss of tax revenue.

For doctors the determination of the value of work in process, or unbilled time, would be extremely difficult, if not impossible. An 'inventory' of unbilled time would in most cases have to be based on a rough estimate and may not be particularly meaningful. There would also be a temptation to use this as an 'income levelling' device.

The use of an accrual system would result in a substantial increase in doctors' accounting costs. It is also much more difficult in many parts of Canada to obtain the expert help necessary to use the accrual method. We have been advised by many of our members, especially in non-urban areas, that it would be impossible for them to obtain the degree of expertise in accounting essential to the operation of an accrual system.

We find it difficult to understand the rationale of this White Paper proposal as it affects the medical profession. Other countries, such as the United States, have not found it necessary to require professionals to adopt the accrual basis of accounting.

Recommendation 4

We recommend that the existing provisions of the Act regarding the cash basis of reporting income for certain taxpayers be retained and that doctors and other professional taxpayers be allowed to use either a cash or an accrual method of computing income.

Gifts

Under the new estate and gift tax legislation which was introduced in October 1968, gifts and bequests between spouses became exempt from gift or estate taxes. The benefits arising to families under this legislation would be significantly reduced if the White Paper proposals concerning gifts in specie are implemented. For reasons of family security, some doctors in the past have transferred property to their wives. Under the White Paper proposals in the case of a gift of property by a husband to a wife, the husband would be deemed to have sold it at its fair market value and to have made a gift of the proceeds. The wife would be considered to have purchased the property at its fair market value.

Because of this deemed realization by the husband, he would become liable for income tax on the excess of the fair market value of the property over its cost, even though he may not have the cash resources necessary to pay the tax.

Recommendation 5

The Association recommends that a 'rollover' provision be introduced similar to that proposed for estate purposes whereby the wife would be deemed to have acquired property gifted by the husband at its cost to the donor. Such a provision would prevent tax being levied on unrealized gains by postponing such tax until the property was disposed of by the wife and could be so arranged that there would be no loss of tax revenue.

Depreciable Property

Under the present system depreciable property left by a deceased person is deemed to be inherited by his beneficiaries at its fair market value, and the deceased's estate is not subject to tax on recaptured depreciation.

The White Paper proposes that depreciable property be deemed to be received by the beneficiary at its cost to the deceased. If such property were sold by an estate, the recapture of depreciation would be subject to income tax even though death taxes had previously been paid on this recapture, thus resulting in double taxation.

This proposal is of some interest to doctors because of the amount of expensive equipment and premises required for a medical practice.

Recommendation 6

We recommend that estate taxes and succession duties paid on the recapture of depreciation be allowed as a deduction from the proceeds of a subsequent sale of the relevant depreciable assets.

Estate Taxes

The White Paper is silent on the combined effect estate taxes (and provincial succession duties) together with the proposed tax on capital gains would have on the accumulation of wealth by Canadians. The Estates Tax Act was amended effective October 22, 1968, and generally speaking, increased the amount of taxation on property passing from one generation to another. The major reason advanced for

an estate tax is that it is a 'final accounting' whereby the estates of deceased persons, who had accumulated large amounts of wealth during their lifetime free of income tax, would be subject to a tax on such wealth.

Canadian doctors have in the past left medium sized estates, but these estates have been accumulated out of after-tax earned income which have been subjected to income tax at high marginal rates of 50% to 60%.

As a result of the change in 1968 of the estate tax rate schedule, taxable estates in excess of $300,000 will be subject to federal estate tax of 50%. The effect, then, of income tax during a doctor's lifetime and estate tax on the accumulated after-tax income is a combined marginal tax rate of approximately 80%.

Since it is proposed to introduce an income tax on capital gains, a major justification for an estate tax, i.e., the final accounting concept, appears to have been substantially eliminated.

Recommendation 7

The Association recommends that the rates of estate tax be substantially reduced or that the estate tax be phased out over a period of years as the tax on capital gains fully matures.

Income Averaging

The government proposes to introduce income averaging provisions so that taxpayers with varying or irregular incomes would

not pay significantly higher taxes over a period of years than would taxpayers with more regular incomes.

At first glance, this proposal would appear to be of considerable benefit to doctors who leave their practices for an extended period of time to take post-graduate courses. However, a closer examination of the proposal reveals that it is quite restrictive and may be of little or no benefit. To even be eligible for averaging, a taxpayer's income for the year in question must exceed the average of the previous four years' income by one-third, and it is only the excess over this amount that would be subject to the averaging provisions. Let us assume that a doctor earned an average of $20,000 per year in the years 1975 to 1977, and that he left his practice for the whole of year 1978 to further his post-graduate education. His income in 1979 would have to exceed $20,000 before the averaging provisions would be of any benefit to him, even though his average income in the preceding four years was only $15,000. Even if his income was $30,000 in 1979, the benefit of averaging would amount to only about $120.

Because of the qualification that only income in excess of four-thirds of the average of the previous four years income is eligible for averaging, the proposal would generally not result in significant benefits to taxpayers such as doctors with irregular or varying incomes. The proposals would not assist taxpayers who suffer a decrease in income.

Recommendation 8

We recommend that all taxpayers be permitted to average their incomes on a basis similar to that now provided in the present Income Tax Act for Farmers and Fishermen.

Fellowships, Scholarships, Bursaries and Research Grants Not Related to Service

The proposal that bursaries and fellowships be taxable in the hands of the recipient will surely lead to a demand that the values of bursaries and fellowships be raised accordingly. Many of these funds come from charitable sources which are already hard-pressed, and others come from government sources, so that taxing the recipients would merely result in money being paid out from one government pocket and returned to another.

Canada already has a 'brain drain' since some of our post-graduate students do not return to this country following post-graduate training abroad. If the funds available to assist post-graduate students become more restricted one can predict a further drain of post-graduates to a country where facilities for further training may be better, bursary and fellowship monies are more easily available and more generously bestowed, and the earnings of specialists less harshly taxed.

We believe that it is essential that the monies available for research in Canada must not be reduced. If the Committee believes that this type of receipt must be taxed to preserve equity, then it is essential that government return the taxes so collected to the granting bodies so that our overall research contribution will not be adversely affected.

Recommendation 9

The Association recommends that fellowships, scholarships, bursaries and research grants not related to service, should not be included in the income base of a taxpayer.

Taxation of Associations' Investment Income

The Canadian Medical Association disagrees with the proposal that the investment income of non-profit organizations should be taxed. In order to carry on its operations, the Association requires a certain level of income. The sources of this income include both fees paid by its doctor members, and income from investments. If the latter is to be taxed, the Association will be forced to increase membership fees to maintain its after-tax income at the required level. Since the fees paid by the Association's members are deductible, there will be a decrease in the income taxes paid by those members, thereby offsetting to a significant extent the taxes collected by the government on the Association's investment income.

The same course of action would no doubt be followed by other non-profit organizations which operate on the same principle as this Association. It, therefore, seems questionable whether the proposed tax would be an effective source of government revenue.

Recommendation 10

We recommend that the investments of non-profit organizations such as the Canadian Medical Association should not be subject to tax.

Automobile Expenses

While the White Paper does not make any proposals in this regard, we believe that existing legislation is not sufficiently explicit in setting out rules for allowable expenses relative to motor cars and similar items of property which are used in part for personal use, in addition to being used in business. For doctors, automobile expenses serve as a good example.

The problem relates specifically to the definition of the word 'use' in Section 20(6)(e) of the Income Tax Act. The Department of National Revenue appears adamant that the definition should relate to the number of miles travelled. We submit that this is a very inadequate definition.

A doctor's automobile is in 'use' in his practice not only when it is transporting him on calls but also when it is merely available for such calls. During the doctor's office hours the car may be parked outside. The doctor may need to use it to answer a call (emergency or othersie), or he may not need it. In either event, the automobile is nonetheless in 'use' in his practice.

For these reasons, we believe that the definition of the word 'use' as it applies to capital cost allowances for doctors' cars should not be related to the number of miles travelled but rather that the definition should take into consideration the essential function of availability as it applies to medical practice.

Recommendation 11

We recommend that an amendment be made to the Income Tax Act

which would distinguish between situations wherein an over-riding necessity for the property is inherent because of the nature of the taxpayer's business, and other situations where the use of the property is ancillary to the business. If the property was deemed to be a necessary and an integral part of the taxpayer's business, we recommend that the full amount of the costs should be used to determine capital cost allowances as other use would be sporadic or occasional. If, however, the property has an ancillary use only, the allocation should be made on the basis now set out in Section 20(6)(e).

Registered Retirement Savings Plans

The White Paper does not make many specific proposals regarding pension and registered retirement savings plans. It does indicate that certain changes in regulations are necessary and implies approval of the Carter Commission recommendation that the deduction allowed for contributions to such a plan be determined by reference to the benefits that the plan would provide.

We agree that certain changes are essential and we believe that they should be an integral part of any substantial changes in our tax laws For example, the present maximum contribution of $2,500 allowable in any one year was established in 1957. Between 1957 and 1969, the Consumer Price Index increased by 32.5%. As we anticipate a further rise in the Consumer Index prior to the implementation of the recommendations of your Committee, we recommend that the $2,500 maximum should be increased to $3,500 and that the same proportionate increase should apply to the $1,500 maximum allowed for salaried doctors.

Further, it is extremely important that this maximum amount of contribution should be changed on a periodic basis in order to make allowance for further changes in the Consumer Price Index and thereby

reflect changes in the purchasing power of the dollar.

It has also been brought to our attention that many of the older members of the medical profession will have an inadequate income on retirement because the period of their retirement savings (since 1957) has been too short to accumulate sufficient capital. We believe that any taxpayer over the age of 50 years should be allowed to make a contribution in any year up to twice the normal allowable maximum and he should be allowed to deduct such contributions from income for tax purposes.

At present there are reasonable averaging provisions available to reduce the incidence of tax on lump sum withdrawals from registered retirement savings plans, and in addition, there is a flat rate of 15% applicable to death benefits received by a beneficiary from such a plan. The White Paper proposes that both these alleviating provisions be abolished, and that lump sum payments and death benefits be taxed as ordinary income. It will still be possible under the proposals for a beneficiary to defer tax on death benefits by transferring them to another registered retirement savings plan in his or her own name, although this will not be of much value if the beneficiary has a need for the money immediately.

The effect of the government's proposals will be a significant increase in the amount of tax exigible on lump sum withdrawals and death benefits, particularly on the latter. For example, assume that a self-employed doctor who has made the maximum allowable contributions of $2,500 annually for a number of years dies suddenly, and that his accumulated contributions and interest amount to $50,000. The amount of tax payable on this accumulation under the present system is $7,5000, but under the proposed system the tax would exceed $20,000, even if the new averaging provisions were used. In fact, the tax liability under the

government's proposals could exceed the tax saved through the annual deduction of contributions, thereby effectively penalizing an individual for participating in a registered retirement savings plan.

The government's proposals could therefore result in unduly high and, in some cases, punitive taxes which could be imposed on lump sum withdrawals from registered retirement savings plans.

The White Paper proposed that foreign investments of registered retirement savings plans should not be allowed to exceed 10% of the assets of such plans. At present, there are no restrictions on the investments of these plans. This proposal seriously limits the range of available investments and restricts the ability of such plans to diversity their investment portfolios in such a way as to provide maximum security and benefits for their members. As a result, individual taxpayers will find it increasingly difficult to provide themselves with an adequate retirement income through a registered retirement savings plan.

Recommendation 12

The Association's recommendations concerning registered retirement savings plans are as follows:

a) That the present maximum contribution of $2,500 be increased to $3,500 and that the maximum contribution for salaried taxpayers be increased proportionately.

b) That taxpayers over 50 years of age be allowed a deduction of twice the normal maximum amount allowable.

c) That maximum allowable contributions be adjusted periodically to reflect changes in the purchasing power of the dollar.

d) That the present provisions of the Act relating to the taxation of lump sum withdrawals and death benefits from registered retirement savings plans be retained.

e) That the proposed restirction on foreign investment by registered retirement savings plans of 10% of their assets be withdrawn, or that this limit be increased to a figure higher than 10%.

Conventions

Present tax regulations allow physicians to claim as a business expense the cost of attending two conventions each year. This provision is important to the physician as it allows him to meet with his confreres, to participate in discussions relating to his professional work, listen to papers presented by experts from other areas and other countries, and to express his views on important health topics of the day.

Medical conventions are also extremely important to the general public. They provide the only mechanism whereby a large number of informed physicians can be brought together to express viewpoints on national or regional health problems. In the last five years, conventions of the Canadian Medical Association discussed, formed opinions and made representations to government on the following topics:

- The public health problems of Indians and Eskimos.
- The definition of death.
- The preparation of an authoritative statement on drug abuse.
- Legislation to allow therapeutic abortions.
- Control of the drinking driver and appropriate levels of blood alcohol.
- Elimination of Customs tariffs on rehabilitation equipment for personal use.

- Use of seat belts in automobiles, crash helmets for motorcyclists, and adequate lighting for all vehicles.
- Safety standards in automobiles.
- Minimum standards for equipment and operation of ambulances.
- Legislation re sale of contraceptive devices.
- Standards and schedules for routine immunization procedures.
- Reaffirmation of desirability of fluoridation of communal water supplies.
- Health hazards of smoking.

We believe that it is important to all Canadians that our conventions continue as they have in the past, and we believe that a continuation of existing rules is essential to obtain maximum participation in these discussions and decisions. Many of these recommendations have resulted in important health legislation contributing to the improvement of the health care of Canadians. If these expenses are not allowed, it is likely that many specialist organizations, whose absolute numbers in Canada are small, will be forced to disband and their members will of necessity seek membership in their larger American specialist societies.

We are aware that abuses have occurred in claiming convention expenses because it has been possible to take advantage of the rules which now apply, particularly with regard to attending conventions in foreign countries. We believe that reasonable criteria could be established so that expenses would not be allowed if the taxpayer attended a convention which was not within his area of interest or which was conducted in a language which he did not speak.

The Canadian Medical Association would be pleased to assist government officials to work out the rules which should apply to attendance at conventions in order to eliminate potential abuse of the system.

Recommendation 13

We strongly recommend that the expenses of attending bona fide conventions should be continued as a business expense.

Courses in Continuing Medical Education

Attached to this brief as an Appendix is a proposal presented jointly by the medical organizations in Canada which have a major interest in continuing medical education. The Canadian Medical Association is one of the participants in this joint brief and wholeheartedly supports the recommendations which will be made to this Committee.

In the past, the expenses of attending courses in continuing medical education have not been allowed as a deductible expense. They have been considered as 'nothings' which could neither be claimed as an expense nor be written off as a capital cost allowance.

The government now proposes that a new depreciation class be established to allow businesses to deduct certain items of expenditure which are presently not deductible, but which are incurred in producing income. These expenditures are referred to as 'nothings' and include such things as goodwill, organization expenses, etc. We have assumed that the costs of continuing medical education would be

included in this category of 'nothings' as recommended by the Carter Royal Commission on Taxation. The Canadian Medical Association believes that this proposal is not sufficient, and that a less restrictive approach to these continuing education expenses should be adopted and the deduction thereof on a reasonable basis should be permitted.

Recommendation 14

We recommend that our proposals regarding costs of continuing medical education, as set out in the appended joint submission, should be adopted.

Respectfully submitted,

THE CANADIAN MEDICAL ASSOCIATION

APPENDIX

JOINT PRESENTATION ON COSTS OF CONTINUING MEDICAL EDUCATION

MR. CHAIRMAN AND MEMBERS OF THE STANDING COMMITTEE:

This Appendix is presented jointly by The Association of Canadian Medical Colleges (A.C.M.C.) and its Associate Committee: The Canadian Association for Continuing Medical Education (C.A.C.M.E.), The Canadian Medical Association (C.M.A.), the College of Family Physicians of Canada (C.F.P.C.) and The Royal College of Physicians and Surgeons of Canada (R.C.P.S.(C)). The above-mentioned organizations are all involved in providing continuing medical education for physicians.

The Canadian Medical Association undertakes to speak for the medical profession in Canada. Its educational counterparts are The Royal College of Physicians and Surgeons of Canada for specialist physicians, and The College of Family Physicians of Canada for doctors in family practice. All sixteen medical schools in Canada are members of The Association of Canadian Medical Colleges. The Canadian Association for Continuing Medical Education includes in its membership the directors of all Canadian university departments of continuing medical education.

Definition of Continuing Medical Education

Continuing medical education is defined as that part of a physician's life-long education which permits him to <u>maintain</u>

up-to-date knowledge and skills. This is essential so that he can deliver a high quality of medical care to the community he serves.

To fulfill that definition he must follow a program of self-education consisting of reading texts and journals and participating in educational activities of his hospital and professional societies. In addition he must attend formal organized programs of continuing medical education at university hospitals or medical meetings in Canada and abroad. To ensure that these programs provide the most efficient learning experience, these courses should be approved by a recognized national medical organization.

Our thoughts as to the necessity of continuing medical education are similar to those outlined in two paragraphs of the Carter Commission Report:

> 1. Increasingly in the modern world, training and education continue throughout a person's working life and do not terminate with the attainment of a certificate or degree. Retraining and upgrading courses of various kinds are becoming an essential feature of many employments and professions. We assume that all of the costs of such courses, both fees and travelling and living expenses in excess of normal living expenses, would be reasonably related to the production of income and should therefore be deductible from income under the general rules for deductibility we recommend. Nevertheless, for greater certainty it might be useful to specify this in the Act.
>
> To permit the deduction of the costs of part-time or short-term training courses should remove a significant tax barrier to the maintenance of the skills and knowledge of both the employed and the self-employed. No concession would be required; only a less restrictive approach to the deductibility of the expenses of producing income. This more liberal approach can be justified on the grounds of equity and neutrality.

The Royal Commission on Health Services has further supported this opinion with the following recommendation which we also endorse.

> 150 That to help ensure that physicians in practice maintain their level of competence, medical schools inaugurate or expand their programmes of continuing medical education, and that fees, travel, and living expenses for attendance at such courses be regarded as deductible expenses for income tax purposes.

*Royal Commission on Health Services, Vol. 1, pp. 71-72

We intend to demonstrate to this Parliamentary Committee that the maintenance of medical knowledge and skills is essential to the delivery of efficient, high quality health care to the nation and would be facilitated by implementation of the above recommendations of the Carter Commission and the Royal Commission on Health Services.

Indications for Need

Various professional medical groups and government departments have shown growing interest and concern about the quality of medical care that is delivered to people by doctors.

The universities have shown their concern by the rapid development of Continuing Medical Education Departments. Ten years ago only three such departments existed, now all sixteen medical schools have such departments. Studies by these departments indicate that the quality of care can be improved by their courses. Considering the geographic problems of Canda, these departments have been a real boon for the rural and small town physician who is not favoured with

such ready access to educational material as his urban counterpart. These departments have provided travelling teams of teachers, expanded medical library service, provided medical education through television and afforded physicians the opportunity to return to a teaching hospital for courses for a minimum period of one week.

Organized medicine, voluntary health agencies, and government have become increasingly concerned with the gap in time that exists between medical discoveries, the development of newer techniques and their utilization in the every-day practice of medicine in various areas of Canada. A President of the United States has stated, "The economic cost of death and disease is staggering beyond one's imagination, and the cost in human agony is far too great to ever tell. The goal is simple, to speed the miracles of medical research from the laboratory to the bedside." We would respectively suggest that Continuing Medical Education is the major avenue available to secure this goal.

Other professional medical organizations have shown their concern with the necessity for continuing education. The College of Family Physicians requires 100 hours of approved study credits every two years as a continuing membership requirement. Since there is a trend in hospitals to require membership in this College for a physician applying for a staff appointment, continuing education is becoming increasingly a necessity for a physician to practice in hospital.

A recent development affecting all physicians has been the stricter enforcement of the Medical Acts in various provinces, which

Acts demand maintenance of a certain minimum level of quality of care for the annual renewal of medical licenses. Evidence of participation in continuing medical education activities as a condition of renewal of the license to practice medicine is already under serious consideration by at least one Provincial Licensing Authority.

Other countries have taken cognizance of the importance of maintaining a high standard of patient care through continuing medical education. We understand that in Great Britain and the United States all expenses associated with continuing medical education are treated as expenses of medical practice and are, therefore, tax deductible.

Status of Continuing Medical Education Courses

Because of the rapid advances in scientific medicine, about one-half of the total amount of all medical knowledge used today will be altered, out-dated or otherwise replaced within seven years. It is a recognized fact by the medical profession that continuing medical education is an essential part of the life of the practising physician. We consider these courses a necessity in today's practice as much as books and equipment. Future developments in medicine will only enhance the necessity for continuing medical education and emphasize its importance in the delivery of high quality care to the community.

Since continuing medical education is now part of the expenses of the practising physician and may shortly become a statutory requirement of continuing medical licensure, we strongly urge the adoption of paragraph 150 of the Royal Commission on Health Services

and the Carter Commission's recommendation that all expenses of a reasonable nature in attendance of courses in continuing medical education be tax deductible.

The amount of time spent annually on continuing medical education may vary considerably depending on the geographic location of the physician, his type of practice and his current educational needs. However, if the physician spent a minimum of two weeks a year, which is the equivalent of the membership requirement of the College of Family Physicians of Canada, the minimum expenses involved in various areas across Canada would be $1,000. Other physicians who require a longer period of study or who must attend courses in other countries will of course incur higher expenses. It is therefore suggested that a reasonable deduction allowable annually for continuing medical education would be actual expenses incurred up to a maximum of $2,000.

RECOMMENDATIONS

We recommend that:

I. Expenses incurred in attendance at approved continuing medical education courses should be deductible for tax purposes.

II. Such courses should be approved by a national medical group, with representation from each of the following organizations:

a) The Association of Canadian Medical Colleges

b) The Canadian Medical Association

c) The College of Family Physicians of Canada

d) The Federation of Medical Licensing Authorities of Canada

e) l'Association des Médecins de Langue Français du Canada

f) The Royal College of Physicians and Surgeons of Canada

III. The expenses claimed should be reasonable and the taxpayer should show:

i) The dates and places of such a refresher course supported by a certificate of attendance from the sponsoring agency.

ii) The expenses incurred including:

a) Transportation expenses
b) Registration or other fee charged for the course.
c) Maintenance - inclusive of meals and hotel expenses.

iii) It is recommended that the allowable tax deduction for continuing medical education expenses be up to $2,000 annually. It is further recommended that where the physician's expenses for continuing medical education in any one year exceed the maximum allowed that he be permitted to defer the excess until the next succeeding taxation year.

Respectfully submitted,

The Association of Canadian Medical Colleges

The Canadian Medical Association

The Canadian Association for Continuing Medical Education

The College of Family Physicians of Canada

The Royal College of Physicians and Surgeons of Canada

Queen's Printer for Canada, Ottawa, 1970

Second Session—Twenty-eighth Parliament

1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 25

WEDNESDAY, MAY 20th, 1970

Nineteenth Proceedings on the Government White Paper, intituled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—25:5)

APPENDICES:

"A"—Brief from Molson Industries Limited.
"B"—Brief from Union Carbide Canada Limited.
"C"—Brief from National Sea Products Limited.
"D"—Analysis of Appendix "C" by Senior Advisor.
"E"—Brief from Atlantic Provinces Economic Council.
"F"—Joint brief from the Co-operative Union of Canada *and* Le Conseil Canadien de la Coopération.
"G"—Analysis of Appendix "F" by Senior Advisor.
"H"—Brief from The National Association of Canadian Credit Unions.
"I"—Analysis of Appendix "H" by Senior Advisor.
"J"—Joint Brief from La Fédération de Québec des Unions Régionales des Caisses Populaires Desjardins; La Fédération de Montréal des Caisses Desjardins and La Fédération des Caisses d'Économie du Québec.
"K"—Analysis of Appendix "J" by Senior Advisor.

22011–1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Isnor
Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Macnaughton
Blois	Giguère	Molson
Burchill	Grosart	Phillips (*Rigaud*)
Carter	Haig	Walker
Choquette	Hayden	Welch
Connolly (*Ottawa West*)	Hays	White
Cook	Hollett	Willis–(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and–
The question being put on the motion, it was–
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and–
The question being put on the motion, it was–
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

22011–1½

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER.
Clerk of the Senate.

MINUTES OF PROCEEDINGS

Wednesday, May 20th, 1970.
(37)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aird, Aseltine, Beaubien, Benidickson, Blois, Burchill, Carter, Cook, Desruisseaux, Everett, Haig, Hollett, Isnor, Kinley, Macnaughton, Molson, Phillips (*Rigaud*) and Welch–(19).

Present, but not of the Committee: The Honourable Senators Laird, McElman, Robichaud and Smith–(4)

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

NATIONAL SEA PRODUCTS LTD.

Mr. H. P. Connor, Chairman of the Board;
Mr. C. R. MacFadden, Vice President–Finance;
Mr. M. L. Pitman, Comptroller;
Mr. H. B. Rhude, Counsel;
Mr. W. O. Morrow, President.

ATLANTIC PROVINCES ECONOMIC COUNCIL.

Mr. C. R. MacFadden, President;
Dr. S. Wayman, Vice President (New Brunswick);
Mr. R. W. Smith, Governor;
Mr. H. J. Flemming, Executive Vice President;
Mr. A. C. Parks, Chief Economist;
Mr. A. L. Boyle, Economist.

CO-OPERATIVE UNION OF CANADA.

Mr. W. B. Melvin, President–Co-operative Union of Canada;
Mr. M. J. Legere, Directeur Général–La Fédération des Caisses Populaires Acadiennes Limitée;

Mr. Y. Daneau, President–Conseil de la Coopération du Québec;

Mr. J. J. Dirker, Solicitor;

Mr. W. E. Bergen, Treasurer–Federated Co-operatives Limited;

Mr. J. T. Phalen, General Secretary–Co-operative Union of Canada;

Mr. A. Morin, Directeur du Service de Recherches–Fédération des Caisses Populaires;

Prof. E. Bouvier S. J., Prof. of Economics;

Mr. E. E. Chorney, Treasurer–United Co-operatives of Ontario.

At 1:15 p.m. the Committee adjourned.

AFTERNOON SITTING

2:30 p.m.
(38)

At 2:30 p.m. the Committee *resumed.*

Present: The Honourable Senators Hayden (*Chairman*), Aird, Aseltine, Beaubien, Burchill, Carter, Connolly (*Ottawa West*), Cook, Desruisseaux, Everett, Haig, Hollett, Isnor, Kinley, Martin, Molson, Phillips (*Rigaud*) and Welch–(18).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

NATIONAL ASSOCIATION OF CANADIAN CREDIT UNIONS.

Mr. G. May, Treasurer–National Association of Canadian Credit Unions (Vancouver);

Mr. L. Tendler, Director–Canadian Co-operative Credit Society (Regina);

Mr. F. Graham, Chartered Accountant (Vancouver);

Mr. J. Dierker, Solicitor (Saskatoon);

Mr. K. Weatherley, President–Ontario Credit Union League (Ottawa);

Mr. R. Ingram, General Manager–National Association of Canadian Credit Unions (Toronto).

LA FÉDÉRATION DES CAISSES POPULAIRES DESJARDINS.

Mr. E. Girardin, Président;

Mr. P. E. Charron, Directeur Général;

Mr. A. Morin, Directeur du Service de Recherches.

Ordered: That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A–Brief from Molson Industries Limited.

B—Brief from Union Carbide Canada Limited.

C—Brief from National Sea Products Limited.

D—Analysis of Appendix "C" by Senior Advisor.

E—Brief from Atlantic Provinces Economic Council.

F—Joint brief from the Co-operative Union of Canada *and* Le Conseil Canadien de la Coopération.

G—Analysis of Appendix "F" by Senior Advisor.

H—Brief from The National Association of Canadian Credit Unions.

I—Analysis of Appendix "H" by Senior Advisor.

J—Joint Brief from La Fédération de Québec des Unions Régionales des Caisses Populaires Desjardins; La Fédération de Montréal des Caisses Desjardins and La Fédération des Caisses d'Économie du Québec.

K—Analysis of Appendix "J" by Senior Advisor.

At 4:30 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, May 20, 1970

The Standing Senate Committee on Banking, Trade and Commerce met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, I call the meeting to order.

Senator Haig: Mr. Chairman, I move that the brief received from Molson Industries Limited form an appendix to our proceedings.

Hon. Senators: Agreed.

The Chairman: Very well, the Molson Industries brief, filed with the committee over a week ago, is to be appended to the proceedings of today.

Honourable senators, we have five submissions today, and the order it is proposed to deal with them in is as follows: first, National Sea Products Ltd.; second, Atlantic Provinces Economic Council; third, the Co-operative Union of Canada; fourth, the National Association of Canadian Credit Unions; and fifth, La Fédération des Caisses Populaires Desjardins.

National Sea Products Ltd. We have with us Mr. H. P. Connor, Chairman of the Board. Are you going to be the spokesman?

Mr. H. P. Connor, Chairman of the Board, National Sea Products Ltd.: Yes, Mr. Chairman.

The Chairman: Would you please introduce your panel to the committee?

Mr. Connor: Yes. I have with me Mr. W. O. Morrow. President of National Sea Products Limited; Mr. C. R. MacFadden, Vice-President (Finance), and Mr. H. B. Rhude, our company solicitor, of the firm of Stewart, MacKeen and Covert, Halifax.

The Chairman: We have read your brief, and the usual procedure is that you make a statement in summary form and indicate headings, if you like, and who is going to deal with them, and then the questions start to pop.

Mr. Connor: Thank you, Mr. Chairman.

Mr. Chairman and honourable senators, I propose to present a summary of the brief and the supplementary brief, which we have already filed with you, and the other members of our group will be available for questioning afterwards.

First of all, I would like to give a picture of our company's business and its operations.

National Sea Products Limited,—for convenience to be referred to in this brief as "National"—carries on the business of catching, processing and marketing fish products. This company owns 42 large deep-sea trawlers. New vessels presently cost approximately $1½ million each and are manned by crews of 12 to 18 men. Twenty-four have been brought into service since 1960. Processing operations are carried on in 16 processing plants. Seven are located in Nova Scotia, four in New Brunswick, and one each in Prince Edward Island, Quebec and Newfoundland.

Senator Aseltine: Where is your head office?

Mr. Connor: In Halifax. In addition, subsidiaries of National operate a fish processing and cooked fish plant in Rockland, Maine, and a shrimp processing plant in Tampa, Florida. One of the Canadian plants is the largest fish plant in North America, and probably in the world.

The Chairman: Located where?

Mr. Connor: In Lunenburg, Nova Scotia.

These processing operations in Canada include the filleting and preparation of fish for marketing as fresh, frozen, smoked and cooked fish products. In Canada National also processes fresh lobsters, frozen lobsters in the shell, frozen lobster meat, canned lobster, frozen shrimp and crab meat. Waste from filleting operations is reduced by further processing to fish meal and other valuable end-products which have become an increasingly important part of our operations.

In 1969 the company completed the construction of its first herring reduction in Shippegan, New Brunswick, and in 1970 a subsidiary of the company opened a new herring reduction plant in Burgeo, Newfoundland. These plants have very great capacity, and each can process 160,000,000 pounds of herring a year.

In the year ended August 31, 1969 gross fish landings at the company's processing plants were 284,000,000 pounds, and sales for the same period were $62 million.

National is the largest fishing company in terms of volume of product and dollar sales on the east coast of North America, and one of the largest on the continent.

The fishing industry is labour intensive. National's processing operations employ approximately 4,100 regular plant employees, 2,000 of which work in the seasonal plants on a six to nine month basis. There are also approximately 150 full-time office and sales personnel, and approximately 2,600 fishermen fish for National.

National's shares are listed on the Montreal stock exchange, and it is a widely-held corporation as that term is defined in the White Paper. It has approximately 1,100 common shareholders, and approximately 500 preferred shareholders. Eighty per cent of all shareholders reside in the Atlantic provinces.

The first point is the effect of the proposed tax integration on investment in National's shares. Over the past six years the company has been engaged in an extensive expansion program. During this period it has invested in excess of $22 million in vessels, plant and equipment.

Cash flow is a most important source of capital funds. A large part of National's cash flow is represented by income taxes which have been deferred as a result of claiming capital cost allowances. In addition to claiming the regular capital cost allowances, provided under the Income Tax Act at the rate of 33-1/3 per cent per year of the net after subsidy cost of its trawlers, National has claimed in respect of some of its fixed assests the accelerated capital cost allowances permitted under incentive legislation, such as the Area Development Act, at the rate of 20 per cent on buildings and 50 per cent on equipment per year. The grants under this act have the further advantage of being non-taxable, and do not reduce capital cost for allowance purposes.

If it were not for the cash flow resulting from claiming capital cost allowance, the company would have been unable to expand at such a rapid pace in recent years. The company had planned to continue this policy of expansion.

A second important source of funds to the company is share capital. If the company is to continue to expand, it must seek from its existing shareholders and the public large amounts of share capital in the next few years. It is in this context that the White Paper Proposals are of greatest concern to the company.

Paragraph 1.10 of the White Paper reads in part as follows:

> The second main objective of tax reform is to see that the tax system does not interfere seriously with economic growth and productivity... Some proposals in this paper are intended to ensure that the incentive to work and invest is not unduly inhibited, and that investments needed for productivity and public purposes are not rejected in favour of less desirable alternatives, just because of their tax consequences."

While the Company is in complete accord with this objective, it respectfully submits that the objective is not realized by the specific proposals put forward. National submits that the proposals relating to dividend tax credits tend to "interfere seriously with economic growth" by favouring investment in mature companies, that do not require new equity capital, and by discouraging investment in growing companies that do need new equity capital.

Under present income tax legislation, a shareholder of a Canadian corporation receives a 20 per cent dividend tax credit whether or not the paying corporation pays substantial tax, little tax, or no tax at all. The White Paper provides that the dividend tax credit to which a shareholder is entitled will be based on the amount of tax paid by the dividend paying corporation.

This proposal, if implemented, would result in very different tax treatment between the shareholders of

(a) Companies which do not require a large investment in depreciable assets relative to their earnings or which have paid for their depreciable assets in prior years by claiming capital cost allowance (for convenience in this brief referred to as "mature companies"); and

(b) Expanding companies such as National which are investing annually large amounts of money relative to their earnings in depreciable assets (for convenience from now on referred to as "expanding companies").

By claiming capital cost allowances, the expanding company can defer payment of much or all of the taxes otherwise payable until a later year. Until then, there is little or no creditable tax that can be passed on to its shareholders in the form of a dividend tax credit.

In 1968 and 1969, as a result of claiming capital cost allowances, National did not pay any Canadian income taxes. Had the White Paper Proposals been in effect in 1968 and 1969, the shareholders of National would not have been entitled to any dividend tax credit in respect of dividends received.

There may be some logic in permitting a dividend tax credit to a shareholder only to the extent that the paying corporation has paid tax. But logical or not, such a policy, if implemented, will seriously interfere with economic growth in Canada, and particularly with economic growth in the Atlantic Region. This becomes apparent on considering the ability of an expanding company to raise share capital.

As shareholders of all Canadian companies are treated equally under present tax legislation, National does not suffer any disadvantage merely because it is an expanding company. However, under the White Paper Proposals, National would be at a considerable disadvantage in raising share capital compared with a mature company, whose shareholders will be entitled to a substantial tax credit. Obviously, the potential investor would prefer to invest in the shares of the mature company rather than in those of the expanding company.

The anomalous result is that the White Paper Proposals induce Canadians to invest in the shares of mature companies which do not need new share capital, and discourages the investment in expanding companies which do need share capital. To use the words of paragraph 1.10 of the White Paper: "investments needed for productivity . . . (will be) . . . rejected in favour of less desirable alternatives, just because of their tax consequences."

While this result will most certainly interfere with economic growth in Canada as a whole, its impact will be greater in the Atlantic Provinces and other slow growth areas than elsewhere. This is so principally for two reasons:

1. All levels of government recognize the need for massive capital investment in the Atlantic Region if its economic expansion is to keep pace with the rest of Canada. By discouraging capital investment in expanding businesses, the White Paper discourages the growth of the area;

2. Federal legislation has encouraged economic growth in the Atlantic Region by permitting accelerated depreciation of new capital assets such as fishing vessels, production equipment and plant. National and its shareholders have been induced by these incentives to invest large amounts of capital in the Atlantic Provinces. If the economic advantages of these inducements can no longer be passed on to the shareholder, then the inducements lose most of their attraction.

Another point is the effect of the two and one-half year restriction on dividend payments. The White Paper proposes that for a shareholder to receive credit for tax paid by a corporation, the corporation be required to pay dividends,—either cash or stock,—within 2½ years from the end of the corporation's tax year.

The Company submits that this is another aspect of the integration concept which will cause serious problems or both Canadian corporations and their shareholders. Many companies, including National, for various reasons will not be able to declare cash dividends each year equal to the profits earned. While stock dividends provide the same tax relief, National claims that they are not a satisfactory alternative for the following reasons:

1. Large shareholders will tend not to object because they will obtain full creditable corporation tax, and they will not dilute their equity position; whereas small shareholders will tend to object, since they produce no cash, and may even result in a cash outlay to pay taxes, and they are relatively uninterested in their equity position.

2. Many companies are precluded from paying stock dividends by virtue of anti-dilution clauses contained in trust deeds securing various forms of debt. National has such a problem in the trust deed securing a convertible debenture issue.

3. The frequent payment of stock dividends changes the capital structure of a company each time it is done, and this tends to leave the capital structure in a disorderly state—obviously not a desirable feature.

Once the two and one-half year period has run out the surplus of the company is, in effect, locked in. The loss of tax credits for shareholders receiving dividends subsequent to this point would for them obviously be a serious matter.

The White Paper also proposes a capital gains tax. In proposing this tax, a distinction is made between closely-held and widely-held corporations. As the shares of National are listed on a Canadian stock exchange, it is considered by the White Paper to be a widely-held corporation. It is proposed that a shareholder of a widely-held corporation will include in taxable income one-half of the gain on the sale of his shares. If the shareholder retains his shares, he will be required to revalue them every five years, and to include in taxable income one-half of the resulting appreciation.

A number of persons engaged in the management of National own large blocks of its common shares. They have no desire to sell them. The investment by managers in their employer's shares is generally regarded as a healthy incentive. National so regards it. In spite of this, the White Paper proposals, if implemented, would place financial pressure on the shareholders to sell a portion of their shares every five years in order to pay taxes on profits that have not been realized.

It is respectfully submitted that such action is grossly unfair to these shareholders. It is also unfair to National, as it impairs the incentive which exists when a manager is a substantial investor in the company that employs him.

More than 90 per cent of the outstanding common shares of National are owned by Canadian residents. Over the past few years, several United States companies have expressed an interest in acquiring control of National. However, the shareholders of National wish to retain their investment in this company, and all offers received have been rejected. It would be most unfortunate if income tax legislation created pressure on these Canadians to sell their shares to foreign companies.

In the matter of business expenses the White Paper proposes "that the Income Tax Act specifically deny deduction for entertainment expenses, . . ." This proposal assumes that there are legitimate business expenses, which should be deductible, and non-legitimate expenses, which should not. Entertainment expenses are deemed to be non-legitimate and, therefore, should not be deductible.

National submits that entertainment expenses are necessary in many businesses. They are as necessary to the sale of a company's goods as advertising, travel, product promotion and public relations. They are incurred in order to sell the goods and earn the income on which tax is paid.

It is submitted that the proposed legislation should not distinguish between business expenses which are legitimate, and those which are non-legitimate. The test should be twofold: firstly, that the expense be incurred for the purpose of earning income; secondly, that it be reasonable. If an expense meets both of these tests, then it should be allowed.

In order to conduct its business to the best advantage, National has in the past and will in the future incur entertainment expenses which meet both of these tests. It submits that these expenses should be permitted.

We have a section with regard to the effect on National's employees' savings and profit sharing retirement plan. It is understood that extensive and fully documented briefs have already been presented to the committee on the effect of the White Paper proposals on a number of companies' employee profit sharing plans. For this reason, it is not proposed to deal in detail with the effect on National's employees' plan, except to explain it very briefly and to reiterate the very adverse financial effect of the White Paper on the plan's members at retirement, particularly those whose income is the lowest.

Seven years ago, National and its employees created a trustee profit sharing and savings plan, the purposes of which are twofold: (a) to provide every regular employee with an opportunity to share in the consolidated profits of the company, and (b) to furnish a means by which each participating employee may accumulate a fund consisting of his own savings, and his portion of the company's contribution together with the earnings therefrom. The main objective of the plan is to provide the employee, on retirement, with an important lump sum contribution to his future maintenance.

The company contributes annually to a trustee-managed fund, 10 per cent of its net profits before

income tax. The employees contribute up to 5 per cent of their earnings up to a limit of $750 each. The plan is voluntary, and on December 31, 1969, had 1,360 members, or 58 per cent of those eligible. Consideration is being given to it becoming compulsory for new employees. The fund at the end of 1969 amounted to $1,960,000.

The White Paper proposal eliminates the provision in the Income Tax Act which allows the taxpayer the option of having a lump sum payment taxed at the average rate of the last three years. An averaging provision is included in the White Paper, but it is far less favourable to the taxpayer than the present system. A number of examples in our complete submission illustrate the adverse effect of the White Paper proposal in different cases in National's plan.

In essence, the examples indicate an average increase in tax of 143 per cent as compared with the present basis. Moreover, the burden of the increase generally falls more heavily on those with the lowest income. This is obviously a most undesirable result. Further, it amounts to retroactive legislation, and punishes the results of an employee's life's work and retirement savings. Many employees have reached a stage in their career where they would not have sufficient time to adjust their affairs to cope with the tax reform proposals. It would probably destroy deferred profit sharing retirement plans as we know them.

It is submitted that the act, as it operates at present, is fair and appropriate, and we urge the retention of the provision for lump sum payments from such profit sharing funds.

In summary, therefore, National finds that certain features of the White Paper proposals would have a very detrimental effect on it and the conduct of its business.

1. As National is an expanding company with large reserves of deferred taxes, the proposed tax integration concept would have the following adverse results:

(a) preclude its shareholders for many years from claiming as much, if any, tax credit as under the present system and consequently

(b) make investment in National's shares relatively less attractive than those of mature companies, and therefore hinder the raising of much needed capital; and

(c) largely cancel out government efforts to assist the Atlantic Province economy under existing special legislation granting accelerated depreciation of captial assets.

2. The requirement that dividends must be paid within two and one-half years from being earned has the effect of a loss of tax credits for shareholders, and puts pressure on management to pay dividends, rather than retain them for growth and expansion, a continual and undesirable pressure on management, and not in the best long term interests of the company.

3. Large blocks of National's shares are owned by its management group. They have no desire to sell them. In spite of this, the proposed five-year revaluation of capital gains would oblige shareholders to sell a portion of their shares every five years to pay taxes on unrealized profits. This is unfair to shareholders and unfair to National, because it impairs the incentive between it and its investing managers.

4. National maintains that if entertainment expenses are incurred to earn income, and are reasonable, they are as necessary an expense as advertising, travel or product promotion, and they should not be disallowed for income tax purposes.

5. The proposal to eliminate the present income tax provision to tax lump sum payments at the average rate of the last three years would more than double the income tax, and fall more heavily on employees with the lowest income, of retiring members of National's employees' profit sharing plan. This proposal is also retroactive in its effect, and punishes an employee's life's work and retirement savings. Further, it would probably destroy deferred profit sharing plans as we know them.

It is my belief that these proposals would not only be bad for National, and bad for the very many other companies like it, but bad for Canada.

Thank you, Mr. Chairman, that concludes the summary.

The Chairman: You have a pension plan as well as the profit sharing plan?

Mr. Connor: No, sir, we do not.

The Chairman: So this is the only vehicle available to your employees to provide for their retirement?

Mr. Connor: This is the only vehicle at present. I should say that we have a pension plan under consideration at the moment, but it is not in effect yet.

The Chairman: You must have prepared some kind of statement or study showing in dollars the position of employees in the different income groups under the present law, and then the difference if the White Paper proposals were implemented?

Mr. Connor: Yes, we did.

The Chairman: Do you think we could have that?

Mr. Connor: Yes. I wonder if Mr. MacFadden, our Vice-President, Finance, would be good enough to deal with that?

MR. C.R. MacFADDEN, VICE-PRESIDENT, FINANCE, NATIONAL SEA PRODUCTS LTD.: Mr. Chairman, I missed part of the question, sitting way back here. Is it relevant to the profit sharing?

Senator Haig: Would you give some illustrations.

Mr. Connor: Would you kindly explain with illustrations the effect of the White Paper proposals?

Mr. MacFadden: We have some examples in our supplementary submission.

The Chairman: Yes, I know. That is on page 4 of your supplementary submission?

Mr. MacFadden: On pages 3 and 4 of the supplementary submission. In example I, a married employee with an average income of $4,000, drawing a taxable benefit of $13,873 from profit sharing, would incur a tax increase of 225 per cent over the present provisions.

The Chairman: If I want to find that in dollars, I go to page 4, do I?

Mr. MacFadden: You go to page 4 and see that under the present Income Tax Act he would pay $1,200 in taxes, whereas on the proposed tax basis it would be $3,900.

The Chairman: How long would such an employee have been in your employ in order to build up that amount of profit sharing?

Mr. Connor: Perhaps I could answer that, sir. This is just for the seven years that we have been operating so far, so it is a very short period.

Mr. MacFadden: There are other illustrations here. Would you like these read?

The Chairman: I see their co-relation. Example 2 is of a single employee, at the present time his tax would be $2,600, and on the proposed basis in the White Paper it would go up to $5,700.

Mr. MacFadden: That is right, an increase of 120 per cent. There are five illustrations in total: $900 increasing to $1,600 in another case; $200 increasing to $500 in another, and $800 increasing to $1,900 in another.

The Chairman: If we look at the White Paper, those in examples 1 and 2 would be people who are held out under the White Paper to come in the group of individuals and new proposed rates who are supposed to benefit by the increased exemptions and by paying less income tax.

Mr. Connor: That is right.

The Chairman: That may be all right as long as you do not put on your penetrating glasses and look at what is going to happen to your profit sharing.

Mr. Connor: That is very true, sir.

The Chairman: There is no reduction in tax when you look at that.

Mr. Connor: These examples are unfortunate in that the profit sharing plan has only been going seven and a half years so the amounts are not large, but by the time it has had a chance to run 20 or 25 years the sums would be very much greater than this. However, we felt we could not possibly deal with the matter except on the facts as they are at present, and that is why we have done it in this way.

Senator Phillips (Rigaud): It is serious enough even so.

Senator Molson: Has there been any communication with your employees on this subject?

Mr. Connor: No, there has not, sir.

Senator Molson: Do you know if the employees themselves have had any opportunity to discuss or be aware of the implications on the profit sharing plan?

Mr. Connor: We have just had the annual meeting of our trustees, and quite frankly the serious effect of this proposal has really only just struck us within the last six weeks and we have not had a chance yet to communicate with the employees.

The Chairman: Do you not think they should be told?

Mr. Connor: Yes, I do.

The Chairman: Are your employees organized?

Mr. Connor: Yes, they are.

The Chairman: So they do have an organization that could make representations on their behalf?

Mr. Connor: Yes, it could be done through the trustees organization, which is behind the whole plan, or possibly through the union.

The Chairman: When I said "organized" I meant a union. They have, then, two ways of doing it: they can make their position known through the trustees, or they can do it through their union?

Mr. Connor: Yes.

Senator Molson: Or both.

The Chairman: Yes, or both.

Mr. Connor: The trustees are a group of 12, six from management and six from the employees.

Senator Burchill: Are some of these profits left with the company?

Mr. Connor: Invested in the company?

Senator Burchill: Yes.

Mr. Connor: There is a small shareholding, I think. Perhaps Mr. MacFadden can help us on this. Is it 2 per cent?

Mr. MacFadden: I am chairman of the trustees, as one of the group of six employee directors who must be members of the board of trustees; there are six trustees who are not directors or officers of the company. The direct answer to your question is that the funds are in the hands of the trustees and there is a committee of the trustees for investment. They in turn are placed in the hands of a management fund or a management company, and they do have a small amount, a very small amount, invested in the shares of the company. It is only 2 or 3 per cent, I think, that they have invested.

Senator Phillips (Rigaud): Following Senator Molson's point, would it be possible to obtain a statement, which in effect would be a further supplement, by way of confirmation of your supplementary submission, either from the trustees or from the union officials, confirming that these figures with respect to the five categories have been checked out by them and found to be in order. Then we will have on file not only the company's submission but the actual views of the ultimate beneficiaries under your profit sharing plan. We will have the complete report, not only from the company but from the beneficiaries under the plan.

Senator Benidickson: Are these illustrations new on this subject.

The Chairman: We have had them from other companies. Were you here when we heard the Dofasco brief?

Senator Benidickson: No.

The Chairman: They have a very substantial profit-sharing plan. They gave us a very graphic picture of it in the course of discussion.

Senator Phillips (Rigaud): If we took examples 1, 2, 3 and 4 which show the actual employees who have a different status, such as single, married, some with dependents and others with no dependents, and made a calculation of their income tax liability under the present law and then their income tax liability in relation to their earnings—not their retirement plan—under the rates in the White Paper, and then if we also made the calculation of what tax the lump sum payment out of the fund would produce under the present law and under the White Paper, I wonder whether that would all add up to show that even the individuals in that group who are supposed to be getting a tax benefit in income tax are not in fact getting it.

Mr. Connor: I would think it would.

The Chairman: I would like to have a look at it.

Mr. MacFadden: Would it be satisfactory if we had a chartered accountant prepare a statement and certify

it? It may be difficult for the individuals or the unions to get too involved in the details.

The Chairman: Whichever is the simplest way.

Senator Phillips (Rigaud): We are looking for a confirmation from the persons directly involved without questioning the credibility of the completion of your submission.

Mr. Connor: You would like to have confirmation from the trustees and possibly the union too?

Senator Phillips (Rigaud): And supplementing not only Senator Molson's thoughts but the observations just made by our chairman by including, in another set of figures, the ultimate effect in respect to categories, inclusive of all their normal taxable income and not isolating, as we have done here, in respect to the profit-sharing plan.

Senator Carter: How long a period is included in these examples?

The Chairman: Seven years.

Senator Carter: Should it not be projected?

Mr. Connor: We do not know what the sums will be. They come from profits which have not been made yet. If we were fortunate to have had a plan such as Dofasco or Simpsons Sears operating for 25 or 30 years, the figures would be very dramatic.

The Chairman: You will recall in the Dofasco brief that in one category regarding the employee retirement plan he would have a lump sum payment available of around $45,000. Under the White Paper proposal he would pay about half of that in taxes.

I take it your employees look upon this retirement savings plan as a method for providing for their retirement?

Mr. Connor: That is right. As I said, it is only seven years. We have just emerged from quite a long strike and we have had very few retirements which are permitted under the plan. This would have been a source of income for them when they were short of money. They definitely place a high value on it.

The Chairman: They are sort of putting it in a pigeon hole for retirement.

Senator Phillips (Rigaud): Mr. Chairman, I take it that we are more or less finished with the point just discussed. I would like to come back to the hard core of Mr. Connor's presentation with respect to integration under the White Paper. Do I surmise properly your statement that the integration system as contemplated by the White Paper hurts areas involved in regional disparities and economic distress?

Mr. Connor: Very definitely, sir.

Senator Phillips (Rigaud): Your basic point is that the hard core of the White Paper hurts those sections of the country which at this stage of development are the most seriously affected economically?

Mr. Connor: That is right, sir. On the one hand, the governments are intending to help us with these accelerated capital cost allowances but, on the other hand, the White Paper has come along.

Senator Phillips (Rigaud): In justification for that statement you say that the cash flow involved on depreciation plus the necessity of the conservative policy in respect of dividends would hurt you very badly?

Mr. Connor: That is correct, sir.

Senator Everett: One of the witnesses who appeared before us suggested that the way around this would be to assume that tax had been paid on any corporate tax allowances such as the type of allowance you have outlined on pages 3 and 4, items 1 and 2—(a) and (b) of your brief. Would that solve the integration problem as far as you are concerned?

Mr. Connor: I am not quite sure that I understand your question, sir.

Senator Everett: It is where you outlined the tax rebates you are entitled to. One of the very large national companies has suggested that it be assumed that tax was paid on those earnings so that on those deductions there would be a tax credit for the amount of earnings paid out.

Mr. Connor: This would cure it, of course, would it not?

Senator Everett: Thank you.

Senator Phillips (Rigaud): Would the senator be good enough to refer to the company that made that

statement. I do not recollect that as being a suggestion from an important large company.

Senator Everett: I do not recall the name, Senator Phillips. I will be glad to consult my files and inform you.

Senator Phillips (Rigaud): I would like to see that and have it referred to in due course in our minutes. I do not recollect such a suggestion at all.

Senator Everett: I will try to refresh you memory.

The Chairman: That would be just creating another fiction, would it not? We have the fiction of partnership option in closely held corporations. They can be incorporated, but they can pay at the partnership rate, which is another fiction and which is supposed to be satisfying the purpose of achieving some discipline in the tax structure.

Senator Molson: You mean it is fiction of the assumption of tax paid in this case?

The Chairman: Yes.

Senator Molson: It is a nice thought. We could carry that through to the personal field.

Mr. Gilmour: The paper released by the Minister of Finance as to how it works certainly made no suggestion that there be any deemed credit. They have given an actual illustration of a company that had substantial cost allowances.

Senator Phillips (Rigaud): Of course, Senator Everett was not referring to the minister's observations. His recollection comes from a suggestion of one of the companies which made representations.

Senator Everett: That is right.

The Chairman: Mr. Gilmour is pointing out that this type of case embodied in what Senator Everett said is not dealt with in the studies we were furnished by the minister. Were you going to follow up on that question of integration, Senator Phillips?

Senator Phillips (Rigaud): I think I have received such a satisfactory answer that I am like the lawyer who is satisfied with the witness—I do not want to pursue it any further.

The Chairman: You may turn a corner.

Senator Aird: Referring to page 3 of the brief, the three sources of funds that have been used in your expansion program, is it a public figure, the percentage which goes to items Cash Flow.

Mr. Connor: I wonder if I might ask for your help, Mr. MacFadden. I do not think it is, but I am not sure.

Mr. MacFadden: The cash flow for the average number of common shares outstanding in 1969 was $3.20 per share. Going back to 1968, it was $1.99; then, 1967, $1.62; then in 1966, $2.86; and it was $2.92 in 1965.

Senator Aird: The reason I asked the question is that you make the major point that it is from this source that you gain a good deal of your capital expansion fund. It would be interesting. I suppose we could obtain it, Mr. Chairman, by reverse logic. We could work out the borrowings under (a) and the sale of the common and preferred shares and therefore the balance is what is in cash flow, but I would be interested to know, of that $3.20 for 1969 how much in fact was used for capital expansion?

Mr. MacFadden: I am sorry. I missed the last part of your question.

Senator Aird: Of the $3.20 cash flow in 1969, how much by way of percentage was used in capital expansion?

Possibly in due course you could discover that figure and supply it to us?

Mr. MacFadden: Yes, we could do that.

Senator Aird: I think it is of interest. What strikes me is the very large distinction that you draw between your company and a mature company. I do not think there are many mature companies that would not regard themselves also as expanding companies. Anybody who is in business and believes in the status quo is not going to stay in business very long in Canada or in any country in the world and I would be interested in how you sustain this argument. Obviously the $22 million is a great deal of money but it has to be kept in perspective.

The Chairman: Senator Aird, looking at the financial statement of the company I see, under source of funds, they show a net income for the year 1969 of $1,351,000 odd. Then they have a list of other items—"add charges not represented by cash outlay during the year; depreciation; portion of tax provision

applicable to future years; and other." Then they show "issue of shares", by which they provide themselves with $1,300,000; and "increase in mortgages", by which they provide themselves with $1,151,000; and a federal grant of $420,000 and disposal of fixed assets of, $26,000 odd. In the application of funds, they show additions to fixed assets, $2,874,000. They show dividends paid—this figure is significant—$285,537.

Senator Beaubien: At how much a share, Mr. Chairman?

Mr. Connor: How much in dividends per share last year?

Senator Beaubien: Yes.

Mr. MacFadden: Common dividends per share, as quoted here, 15 cents per share. In grand total, the dividends per preference share were $106,000; and in common shares $179,000.

The Chairman: There were 1,196,143 common shares outstanding.

Senator Aird: I gather that the dividend rate was 15 cents per share and the cash flow was $3.20 per share.

The Chairman: Yes.

Mr. Connor: That is the common dividend.

Senator Aird: What was the preferred dividend?

The Chairman: The shareholder has not been oversupplied.

Senator Laird: That is my point.

The Chairman: The retained earnings entered very largely, I would say, into the picture of the expansion of this company.

Senator Phillips (Rigaud): If Senator Aird has completed, may I put a question.

Senator Aird: Yes.

Senator Phillips (Rigaud): I would like to go back to integration for a moment. You have taken such an emphatic stand on it. On the assumption that we had integration—which, as far as I am concerned, is a consummation devoutly not to be wished—but on the assumption that we had it, have you given any consideration as to whether there should be a distinction between publicly listed companies and private companies with respect to the treatment of the creditable tax and so on? Do you think there should be a distinction, on the assumption that we had an integration system?

Mr. Connor: Frankly, sir, I have not considered that.

Senator Phillips (Rigaud): Has anybody in your panel considered that—because we have been canvassing the views of the public on that point.

Mr. H. B. Rhude, Counsel, National Sea Products Ltd.: Senator Phillips, if I might comment on that, the distinction appears to be a most artificial one. I am speaking personally, perhaps. I do not see on what basis it can be justified. Undoubtedly, difficulties will arise also, in drawing the line between the widely-held corporations and the closely-held corporations. One can envisage the same sort of difficulties that Mr. Benson speaks of in associational companies, and the difficulties he says the department has had for many years in trying to see that the people do not get the advantage of the $35,000 tax, the lower rate for the first $35,000. One can see the difficulties here. We do not know exactly what they may be, because there is no real definition in the White Paper as to the distinction between these two classes of corporation. I suggest that it is a completely artificial kind of distinction, one would guess made for the purpose of the revenue, of the amount of tax that is collected, rather than the equity which the White Paper pursues.

Senator Phillips (Rigaud): This is your view as a lawyer at Bar, rather than representing the present company?

Mr. Rhude: That is correct.

Senator Phillips (Rigaud): May I put another question, Mr. Chairman?

The Chairman: Yes.

Senator Phillips (Rigaud): With respect to capital gains, as you come from a very important area of our country, do you feel that we should have a capital gains tax, or that it is inevitable, and that this committee should so regard it as inevitable; and, if so, how should it be treated?

Mr. Connor: I am speaking personally now, when I say this, Mr. Chairman.

The Chairman: Yes.

Mr. Connor: Frankly, I am one of those who still believe that there should not be a capital gains tax in Canada. I think we are still a country which has so much in the way of expansion ahead of us that this will tend to deter our expansion. But I do feel that it is probably inevitable, in a democratic country such as we are. And, if that is the case, what does surprise me is the amount, the size of the tax which is proposed. Frankly, I had thought that, if it came, it would be in the region of 10 to 15 per cent on a capital gain, and I was very surprised to see that it amounts to 50 per cent of the gain in the case of a foreign capital gain and roughly 25 per cent or maybe a little higher in the case of Canadian capital gains. But these are my personal views.

Senator Phillips (Rigaud): I gather you do not see any merit in it being included in ordinary income on an integrated system?

Mr. Connor: No, I think it would be far better to have it separate, as the Americans do.

The Chairman: This might be a good time to make a reference. I have been looking for a spot where I might refer you to a budget speech which the Honourable Mr. Sharp made when he was Minister of Finance, and after the Carter Report had come in. It is rather interesting to read what he, as Minister of Finance, had to say in November of 1967—and I have to assume, since it was a budget speech, that it represented Government policy at that time. I might just take a minute on it, as I think it is in line with some of what Mr. Connor has said.

The minister said:

> I have been particularly impressed that four points have played a central role in the public discussion of the report, and in the submissions made to the government. The first is the sweeping extent of the changes recommended by the commission, and the difficulty of predicting the effects that sudden changes of this magnitude would have on the economy and ultimately on the position of various taxpayers. We have encountered this difficulty ourselves. The second point is that the commissioners have suggested for Canada a tax system quite different from that of other countries, and in particular quite different from that of the United States with whom we have an integrated capital market. This could give rise to economic difficulties, as well as to technical problems in drafting an effective law. The third point is somewhat related to the second, although it has connotations in other areas as well. It is that Canada will need to generate and invest a large volume of savings over the next decade in order to carry out the economic growth and development we want, and we shall need to attract substantial amounts of foreign capital to supplement our own savings. Many people feel the commission did not give adequate weight to this consideration in deciding on its recommendations, and I am inclined to agree. The final point is a widespread concern over the regional impact of the commissioners' proposals, particularly those related to the mining and petroleum industries.

Then in his conclusions the minister had this to say:

> However, the work we have done within the government, as well as the analyses we have received from others, leads us to the conclusion that while the reforms we will place before parliament and the public in the form of a White Paper and ultimately in draft legislation will undoubtedly be influenced by the monumental report of the royal commission, they will be more in the nature of reforms of the existing tax structure rather than the adoption of a radically different approach. They will not necessarily be limited to items which the commission has recommended.

That is a rather significant statement and analysis by the then Minister of Finance as to the impact of proposals.

Senator Macnaughton: Mr. Chairman, would you give the official source of what you have just read?

The Chairman: Yes, senator. It is from the *Hansard* Debates of the House of Commons for Thursday, November 30, 1967, and I was reading from page 4906.

Senator Aird: Mr. Chairman, carrying on with the line of thought you recently expressed, once again going back to the brief, the company indicates that it had planned to continue its policy of expansion. Is it a fair statement to make that, because of the White Paper and because of the present market conditions both in Canada and the United States, your plans for expansion are in a state of suspension?

Mr. Connor: I would not like to say, Senator Aird, that we have gone that far; but I think it is clear to us that, if the White Paper proposals are implemented, they will have a very contracting effect on our expansion plans, simply by virtue of cutting off some of the sources of funds that we would have for expansion.

Mr. W. O. Morrow, President, National Sea Products Limited: It would place some of our Canadian priorities further down the list and we would probably expand on the American side where we have formulated plans. But today there is more incentive really to expand in Canada.

Senator Aird: Under the present structure in Canada you would be oriented towards expanding in Canada, and Tampa, et cetera, would have second priority.

Mr. Morrow: Well, Tampa is not a very good illustration. It is very high on our priorities at the present time. But certainly it would lower some of our Canadian expansion plans down on the priority list. There is no question about that.

Senator Beaubien: Mr. Morrow, in your American subsidiaries what is the tax structure there? Is it more favourable than the White Paper would be?

Mr. Morrow: Well, basically no. I would not say it is more favourable. We have incentives in Canada today under the present system that would make the expansion in Canada more favourable.

Senator Beaubien: But if the White Paper were implemented, how would you stack up with the laws in the States? You have two plants there, haven't you?

Mr. Morrow: Right. We would have to look at the situation. I wouldn't know right off hand, but I should think some of our priorities would move up the list pretty fast in the United States.

The Chairman: You say some of your priorities. What do you mean? Where?

Mr. Morrow: We are expanding in Tampa and the Rockland area. We have large plans for both those areas.

The Chairman: Would that involve exporting the raw fish to your American plants?

Mr. Morrow: We do that now. We would probably get into the final processing business in a larger scale in the United States, though.

The Chairman: You mention about incentives under the present law; would you enumerate them for purposes of the record?

Mr. Morrow: They are outlined pretty well in the brief. I might say that if the advantages that we have in our deferred tax position were removed, that would certainly be one factor.

The Chairman: The subsidy that you were getting on shipbuilding runs out in 1974, is that correct?

Mr. Morrow: What subsidy?

The Chairman: The subsidy on shipbuilding.

Mr. Morrow: That is a subsidy to the shipyards. The incentive there is accelerated depreciation.

The Chairman: Right, but you can only depreciate your cost.

Mr. Morrow: That is right.

The Chairman: You cannot depreciate the amount of the subsidy which is part of the capital cost.

Mr. Connor: But as I understand it, and Mr. MacFadden can correct me if I am wrong, the special construction assistance capital allowances are a continuing thing and they are right in the Income Tax Act today. Is that not correct, Mr. MacFadden?

Mr. MacFadden: The first advantage or incentive that we have is under the ADA program which runs on for a few years yet on any construction made in the last few years. That incentive is on buildings, where you depreciate your buildings over a period of five years and your fixed assets over a period of two years.

The Chairman: The ADA program was the one where you could depreciate even the capital grants. Is that right?

Mr. MacFadden: You could depreciate the capital grants, yes. Now, that program is running out. We were speaking of subsidies and I think we should get this clear. There is a subsidy given to shipyards for the

construction of ships in Canada. That is to encourage companies to build ships in Canada rather than building them in foreign shipyards. That is one subsidy. That goes to the shipyards. Under the tax act there is for ships a special depreciation of one-third. They can be written off over a period of three years. That is an incentive.

Mr. Morrow: For those built in Canada.

Mr. MacFadden: For those built in Canada, yes. This is very helpful in your cash flow. It is very important in a growing company to have this sort of capital available.

Senator Aird: Mr. Chairman, that is my point. As it relates to the $3.20, 1969, this is the key to one of the questions we are trying to answer. I think the cash flow of this particular company is an integral part of its growth factor, and I think it would be useful to know how much of that, in effect, is used on the expansion side.

The Chairman: Of course you take the figure of $3.20 for 1969 and you subtract from that right away the amount paid out in dividends.

Senator Beaubien: Fifteen cents.

The Chairman: Can we assume that all the rest of it went into investment in plant and expansion of plant, or were there some other diversions?

Mr. MacFadden: In 1969, just looking at our figures quickly, to the cash flow, which is commonly referred to as your profit, you add back your depreciation and this amounts to approximately $4 million in National Sea Products in 1969. Out of that $4 million we spent $2.9 million in fixed assets during that same year.

Senator Molson: Mr. Chairman, might I ask Mr. Connor if he has any view about the small business tax proposal—to eliminate the 21 per cent tax on the first $35,000 of profit.

Mr. Connor: Well, sir, of course it does not affect a company such as ours as much as it would affect a small company, but my view is that it will be much better to retain the present lower tax rate for the first $35,000 profit. This is a vital source of cash or funds to these small businesses which need it, and it is not an answer, I think, to say that a *quid pro quo* can be granted by giving a capital cost allowance at some future date. We don't know what these are, although the Government has suggested this is going to be done. But they are only available for investment in capital and not, for instance, inventory or other purposes which may be just as important to small businesses. I think it is a regrettable thing.

The Chairman: Would you say, arising out of your answers to that question, that small businesses, and let us put in that category businesses having net profits up to $75,000 or $100,000—would you say that they need to have available as much as possible in the way of retained earnings so as to provide their own capital for operations and expansion?

Mr. Connor: I most certainly would.

The Chairman: My emphasis is on the word "need". I am not going to the case where it has been suggested that small businesses have incorporated to take advantage of the 21 per cent on the first $35,000 as has been suggested. All you have to do is read *Hansard*, and you will see in the Commons *Hansard* where this statement has been made. But there is a real need in your opinion?

Mr. Connor: That is right. I believe that firmly.

The Chairman: Are you in a position on this particular subject to express an opinion that we can attach value to?

Mr. Connor: You mean as far as my personal relationship is concerned?

The Chairman: Or knowledge or information.

Mr. Connor: Only that of a businessman who fully appreciates the need for funds of this type for the vital requirements that a business has. This is more so in the case of a small business than a large business that has other sources of raising funds.

The Chairman: The capital investing section of the public is not attracted to small business as a source of investment?

Mr. Connor: That is so, Mr. Chairman.

Senator Phillips (Rigaud): Mr. Connor, I would like to go back to pages 10 and 11 of your brief dealing with capital gains, and your obvious sincerity and that of your company, and I would like you to emphasize again the statement on page 10 which you express a view, a very strong view against "deemed to be sales at the end of every five years" and where you say:

> If the shareholder retains his shares, he will be required to revalue them every five years and to include in taxable income one-half of the resulting appreciation.

Then on page 11 you make the following statement:

> It is submitted that the pressures on holders of large blocks of shares to sell portions of their holdings will stimulate the takeover of many companies by foreign interests.

We have had such statements made by other taxpayers, and I would like you to tell us directly in addition to your brief that today it is your considered opinion on that point, and that of your company.

Mr. Connor: I have no hesitation, senator, in confirming those statements. That is what I believe, and that is what my associates in this company generally believe.

Senator Phillips (Rigaud): Thank you very much.

The Chairman: Getting back to Senator Aird's question which you were dealing with, it would appear from quick arithmatic that the cash raised by this company in 1969 represented by income, depreciation, capital stock, and the increase in the mortgage would be $6,333,000. Now a big item there is the depreciation which is over $2,500,000. For how much longer can you count on that element as part of your generating your cash flow? Surely your depreciation is going to taper off. You have accelerated rates or quick write-off.

Mr. Connor: We also have a very large expansion program. As long as we continue to do this and these capital cost allowances are available to us, then these sources of funds will be there.

The Chairman: Yes, but of course you have to keep earning.

Mr. Connor: That is true.

The Chairman: And you have to go through with your expansion program. You have not exactly answered my question. Let us assume that I am looking at the end of 1969, and I am saying the depreciation is a source of funds on the basis of this statement. I am asking how long it will last.

Mr. Connor: I wonder if I can get a little help on this.

Mr. MacFadden: It depends, of course, on the profit because the depreciation of capital cost allowances will be based on the profit. But based upon our best estimate as of 1969, we anticipate that in two years it will be gone down to a normal amount of depreciation.

The Chairman: What is a normal amount?

Mr. MacFadden: Well, the ships will be all depreciated, and the normal assets that are not subject to special depreciation will be all we have left.

The Chairman: How much will this figure of $2,500,000 be reduced to when you get on the basis of normal depreciation on the diminishing balance basis? Would it be cut in two?

Mr. MacFadden: It would be. If you will just give me a second, I have to get the wheels turning here. I think, sir, it would be more than cut in two. But I cannot give an exact figure in answer to that.

The Chairman: You think it would be reduced by more than 50 per cent?

Mr. MacFadden: Very considerably.

The Chairman: By much more than 50 per cent?

Mr. MacFadden: At least 50 per cent of what it is and possibly more.

The Chairman: Would it be fair to say that the figure at the end of two years might be, say, 15 per cent of the present figure?

Mr. MacFadden: I would not want to say that too quickly offhand because there are other factors.

The Chairman: Am I even in the ball park?

Mr. MacFadden: I think the 15 per cent figure would be entirely too low. I think it will be much higher than that. But, as I say, I cannot give an exact figure. But in two and a half years the special depreciation will be run out and we will be back on the normal tax basis.

The Chairman: But you are writing off your ships on the basis of one-third each year for three years, and that runs into a substantial amount of money.

Mr. MacFadden: But we have not built any new ships for a couple of years, and also I should point out that we have not been writing off one-third each year because we have not had sufficient profits to write off the full amount of capital cost allowance, so this is why it will still run for the better part of two years yet.

The Chairman: You have been getting special capital cost allowances in connection with some of your plant and equipment, have you not?

Mr. MacFadden: Yes, that is right sir.

The Chairman: And that is a five-year period?

Mr. MacFadden: This is a five-year period. It is a five-year period for buildings or a two-year period for machinery and equipment. Speaking on taxation, we have had more capital cost allowance than we have been able to utilize, so it is difficult to make a perfect measure.

The Chairman: The brake on your spending or taking advantage of your capital cost allowance has been the amount of your earnings?

Mr. MacFadden: Yes, that is right.

Senator Beaubien: Mr. MacFadden, how long are you taking to write off your ships, then? Instead of three years are you taking five? Is that it?

Mr. MacFadden: We would like to write them off in three years, but we write them off depending on our earnings available in Canada.

Senator Burchill: Mr. Chairman, I would like Mr. Connor to say a little more about the incentives to expand in the Atlantic provinces as compared to the United States. We know what the advantages are today, under the present income tax legislation, but what is going to happen if the White Paper comes into effect?

Mr. Connor: I have not thought this matter out beforehand, sir, but it would seem to me that we would then be in a position much like we would be in in the United States, and we would have lost our relative incentive advantage to expand in Canada. This is an unschooled answer because I have not studied the facts carefully.

The Chairman: Senator Burchill, suppose we leave this question up to Mr. Connor and ask him if he will address himself to it and send us a supplement to his supplementary brief?

Senator Burchill: Yes, because I think it is vital to us down in the Atlantic provinces to have an answer to this question.

Mr. Connor: We would be pleased to do that, senator.

Senator Everett: Mr. Connor, coming back to the point made by Senator Phillips in connection with your submission at the top of page 11, for the purposes of the record I wonder if you could give the committee more details of the stimulation of take-over of the company by American or foreign interests?

Mr. Connor: Senator, this is a public hearing and I think you can appreciate my reluctance to go too deeply into such a matter.

Senator Everett: I can.

Mr. Connor: I do not know just how far you want me to go, but obviously I am not prepared to go into too much detail, except to say that it is the sort of thing that is going on in business, as we know it, all around us all the time, and it has certainly happened to us.

The Chairman: What would be the attraction to an American purchaser to make a take-over bid at this time?

Mr. Connor: Of a company such as ours?

The Chairman: Yes.

Mr. Connor: I think the attraction would be great. First of all, we are a very large exporter of goods to the United States. 70 per cent of our product is sold in the United States. We already have a good business there, with two large subsidiary companies. We are one of the largest fishing companies in North America. We would fit very beautifully into some of the large American food companies.

Senator Everett: I am thinking more of the situation that would obtain, not necessarily for your company but for companies in a similar position to yours, if the White Paper were implemented.

The Chairman: My question was what was the attraction for the American purchaser. You do not

necessarily have to relate it to your company but a company like yours.

Mr. Connor: I do not know whether I am answering correctly or not, but it seemed to me too that obviously American companies are the ones that are today on the expansion or diversification trail. They are the companies, of all the companies in the world, that have large sums of money at their disposal and are ready to move. We are just the type of company they are looking for.

Senator Everett: But that is a situation that would obtain if the White Paper were or were not implemented.

Mr. Connor: No, if the White Paper were implemented, then with the business of taxation every five years we would have to be selling our shares and it would be very difficult to hold control such as we now do. You are just in a much less relatively good position to hold on to what you have if the White Paper proposals are implemented.

Mr. Morrow: Large blocks of our shares are held by the management group.

Senator Everett: But what we are trying to arrive at is not whether the management group hang on to those large blocks of shares, but being forced to sell them by the quinquennial valuation provisions. What we would like to get on the record is why they would go to foreign holders.

Mr. Morrow: They would be more widely held, and it would be easier for somebody to come in and make a successful bid for shares and have an interest in a Canadian company owned and controlled in Canada and specifically in the Maritime provinces where most people understand the business.

Mr. Connor: Is it not true that there are so many more companies than there are in Canada on the acquisition trail that have the funds to do it?

Senator Everett: Yes, but it seems your basic point regarding the White Paper is that the quinquennial valuation will force the breakup of closely-held ownership of your shares, thereby distributing the ownership more widely and thereby leaving you a target for take-over which is likely to be foreign in nature. Is that correct?

Mr. Connor: Yes.

The Chairman: There would have to be a second prong to what you are saying. That is that the non-resident who is making the take-over bid would have to be either an individual or a corporation, so that such individual or corporation would get the status of a closely-held company under the White Paper proposals that would not be subject to the five-year revaluation. National would become a closely-held corporation itself.

Mr. Arthur W. Gilmour, Senior Tax Adviser: And there would no longer be any five-year revaluation, so it would make it extremely difficult for these gentlemen to hold on to control of what is today a widely-held company.

Senator Everett: Would that route be available to both Canadian and foreign interests?

Mr. Gilmour: Yes. The five-year revaluation ensures that a group of Canadians, either a family or a group, cannot retain control of what is a widely-held Canadian corporation, and the irony of the whole situation is that if a non-resident takes over, the non-resident will force out the remaining minority shareholders—it will be to their advantage—and assume 100 per cent control, so that they exempt themselves from the five-year revaluation in the future.

Senator Everett: But a Canadian group taking over would have the same opportunity, I gather, as a foreign group to create a closely-held holding corporation that would not suffer revaluations?

Mr. Gilmour: Yes, by eliminating the present minority shareholders, the public shareholders, in the company.

Senator Beaubien: Does not the White Paper say, "Once widely held, always widely held"?

Mr. Gilmour: Yes.

Senator Beaubien: So it would not become a closely held. The White Paper has said that, as I remember it.

Mr. Gilmour: It would not be very difficult to reorganize the affairs, Senator Beaubien.

Senator Beaubien: I see.

Senator Phillips (Rigaud): Mr. Chairman, I would like to put the one question under this heading,

and I think it will tidy up the point we are assuming Senator Everett is driving at. If we eliminate integration and have a capital gains tax without this five-year revaluation then, in your opinion, Mr. Connor, would this improve the situation with respect to foreign takeovers? Would they be lessened?

Mr. Connor: Yes, it would, sir, definitely.

Senator Phillips (Rigaud): I think that that question and answer may tidy up our thinking, Mr. Chairman.

Mr. Rhude: There is just one other fact that I do not think anybody has mentioned, and it applies particularly to National and companies like National that take large amounts of capital cost allowance and have no taxable credit to pass on to their shareholders. The inevitable result is that the shares of a company like National will be depressed on the market—they will be of less value to Canadian investors—whereas the shares of what we have referred to as mature corporations will be more valuable. The foreign investor does not get a taxable credit anyway because he is a non-resident. There is no taxable credit for the American investor, but he will get his tax advantages in his own country.

The Chairman: He will be subject only to the Canadian withholding tax.

Mr. Rhude: Yes, the 15 per cent.

The Chairman: And he gets credit for that in his home base

Mr. Rhude: Yes, sir, and this means that the Canadian is investing in mature companies and not in companies like National which are expanding, whereas the foreign investor does not care.

Senator Everett: Do you not agree, Mr. Connor, that that is a crucial point?

Mr. Connor: Yes.

The Chairman: If there are no other questions then I will thank you, Mr. Connor and your group, for your presentation.

Mr. Connor: I thank you, Mr. Chairman and honourable senators, for a very generous hearing.

The Chairman: The next submission is by the Atlantic Provinces Economic Council. I will ask Mr. MacFadden, the President of the Atlantic Provinces Economic Council, which is also known as APEC, to present his delegation. You are going to make an initial statement, are you not, Mr. MacFadden?

Mr. C. R. MacFadden, President, Atlantic Provinces Economic Council: Yes, Mr. Chairman. I should like first of all to introduce my colleagues who are with me this morning, and as I mention their names I will ask them to stand and thus identify themselves.

Dr. Stephen Wayman of Saint John, New Brunswick, who is the Vice-President of the Atlantic Provinces Economic Council for that province. I might mention that Dr. Wayman is a former Mayor of Saint John and a former Minister of Health for the Province of New Brunswick.

Mr. Robert W. Smith, who is a Governor for Prince Edward Island. Mr. Smith is the General Manager of the Maritime Electric Company in Charlottetown, Prince Edward Island.

Mr. Harold J. Stafford is another member of our group but he is unable to be here today as he is attending the labour convention in Edmonton. He is a Governor for Prince Edward Island, and he is the Director of Education for the Canadian Labour Congress in Saint John, New Brunswick. He has asked me to express his regrets.

I should like now to introduce three of our staff members who are with us today. First of all, there is our newly appointed executive Vice President, Mr. Harry Flemming of Halifax. Mr. Flemming takes office with us on June 1.

Mr. Arthur C. Parks, who is our chief economist, is on my immediate right. Mr. Park's assistant, Mr. Boyle, an economist, is also in attendance.

Mr. Chairman, I should like to read an introduction, if I may, which gives the background and a brief summary of our submission. If I may, I will proceed on that basis.

The Chairman: Very well.

Mr. MacFadden:

The Atlantic Provinces Economic Council welcomes this opportunity of submitting its views on the *Proposals for Tax Reform.* The Council commends the Government particularly on the method by

which it has seen fit to submit its proposals to public scrutiny and appraisal before undertaking to make them law. Such a gesture is certainly a welcome one to the nation's population.

The Atlantic Provinces Economic Council is an independent, non-political, non-governmental organization formed in 1954, to promote and encourage the economic and social development of the whole Atlantic region so that Nova Scotia, New Brunswick, Prince Edward Island, and Newfoundland may share fully in, and make their maximum contributions to, Canada's national development.

The Atlantic Provinces Economic Council strives to achieve this purpose through the pursuit of four primary objectives:

(1) The encouragement of substantial increases in employment and productivity.

(2) The promotion of the most efficient use of the region's total resources—both human and material.

(3) The recommendation of public policies and programs that will stimulate economic and social development.

(4) The encouragement of inter-provincial and federal-provincial co-operation and co-ordination.

The Council's work is financed mainly through membership contributions received from individuals, organizations and businesses interested in the Council's aims and anxious to share in the development of the region.

It will be appreciated that the *Proposals for Tax Reform* are of great concern to the Atlantic Provinces Economic Council. This submission in presented so that the Council's view may be publicly expressed and with the hope that some consideration may be given to these views.

I may say that this is not the first time that the Council has presented its views on tax reform to the nation. In 1963 the Council was pleased to offer a submission to the Royal Commission on Taxation. At that time the Council solicited the support of the Government of Canada for the activation of a comprehensive development scheme to and the region in alleviating the disparities which existed, and which still exist, between the region and the great nation of which it is a part. Since that time numerous developments have taken place which bode well for the economic development and growth of the Atlantic provinces. The most important occurrence, of course, has been the formation of the Department of Regional Economic Expansion.

Mr. Chairman, I should like now to proceed with a summary of our brief, which is as follows:

The Atlantic Provinces Economic Council recognizes the need for revision of income tax legislation in Canada. The general view of the proposals for Tax Reform of a need for greater equity in the tax system without impinging on economic growth is accepted.

We submit that the use of the tax system is neigher the most efficient nor the most effective method of inducing economic development in those areas of the nation which suffer from regional disparities. However, it is most important that the tax system not offset the impact of incentives available under other policies designed to achieve specific objectives. This is especially significant in the Atlantic Provinces because of the policies and programs designed to broaden the industrial base of the region. Taxation policies must not be permitted to dampen the effects of these programs. Taxation policies do, however, generally influence industrial, economic and social development. It is in this light—the way in which the tax proposals could help or hinder the economy of the Atlantic Provinces—that we have viewed the Proposals.

Referring further to the statement that taxation policies must not be permitted to dampen the effects of these programs, we point out that the part of assets purchased with funds obtained as a grant towards capital cost as an incentive through the Department of Regional Economic Expansion are not depreciable. This not only limits the usefulness of the grant, but also is detrimental to those firms with capital incentive operations, many of which constitute the growth industries of the future. It could significantly alter the industrial structure of the region, whether in yield, in value or employment.

This is one important case where policies of the Government could seriously hinder the intent and success of other areas.

It should also be mentioned that a tax system should not discourage private investment in growing business with large investment in depreciable assets, in private utilities or in other areas of activity contributing to economic development.

It has been argued, for example, that the tax proposals would discourage investment in the private utilities and in public companies with large investment in depreciable assets by a reduction or elimination of tax credits to the individual shareholders. We urge that these matters be given every consideration with a view to the fair treatment of all shareholders.

Small businesses encounter numerous problems relative to their larger counterparts. The most important handicap with which they are burdened is the difficulty in procuring funds for expansion and modernization. They are hampered by limited access to funds and higher costs compared to larger industrial concerns. This principle of the need of small businesses for expansion capital was recognized and legislation so implemented through the establishment of the dual tax rate on corporate income. The Proposals for Tax Reform does not recognize this principle. We believe this omission could have serious consequences on both the national economy and the regions which compose it. Thus, although, we are in accord with the principles on which the White Paper is based, we do have reservations concerning the mechanics advanced as a means of translating the principles into action.

The aim of establishing a degree of integration between the personal and corporate income tax system we view with general accord. However, we do have serious reservations concerning the proposed taxation of unrealized capital gains, particularly the proposition to tax deemed gains on the shares of widely-held Canadian corporations every five years. Such a move, we feel, is unwise, unjust and unsuitable to the present stage of the nation's development. Not only does this represent a significant departure concerning taxation policies in Canada, it also could impose a deterrent to the investment so necessary for the continuing economic advance of the nation.

Although we recognize the need for a system of income-averaging, especially when capital gains to varying degrees are drawn into the tax base, we have reservations concerning the complex method proposed for doing so. We believe it falls short of meeting the taxation canons of simplicity, ease of administration and ease of collection.

We concur with the proposals to raise personal exemptions and the wise decision to relate any change in deductions for dependents to changes in national social security and social development programs. Proposed deductions for child welfare expenses, employment expenses, moving expenses related to changing jobs, the exclusion from income of living allowances paid under the Adult Occupational Training Act, taxation of unemployment insurance benefits and deduction of payments are all proposals that would contribute to the progressive social and economic structural change necessary for economic development.

The stringent measures proposed for the treatment of business expenses we view as unduly harsh. Existing legislation concerning treatment of business expenses for tax purposes and the proposal to allow general deduction of employment expenses for wage and salary earners should be sufficient to offset any imbalance which has occurred in the past. Moreover, implementation of this suggestion as outlined in the White Paper could have a serious disruptive effect on the need of businessmen and professionals to become familiar with new developments in their respective fields. This is especially important to those engaged in pursuits where large internal research facilities are not available and who are located in areas removed from the mainstream of technical, managerial and administrative development.

Although the aim of alleviating the tax burden of those in the lower income categories cannot be disputed, and although realities compel that the middle income groups bear the brunt of the cost of this, we would recommend that the government lighten this load if revenue yields exceed those anticipated. It is also imperative that the level of taxation in Canada not become so onerous that it differs significantly from those countries with which the nation must compete for both personnel and capital. This is especially important with respect to those highly trained, highly mobile personnel who, to a great extent, would be hit hardest if the tax proposals were to be implemented as legislation.

We find it difficult to agree with the proposal which would not recognize the principle inherent in the establishment of the dual tax rate on corporate income, especially since the concessions proposed do not seem sufficient to offset the increased burden. The principle which was taken into account when the dual rate system was originally established—that small businesses are hampered in obtaining funds for expansion—is still relevant today. Therefore, we do not feel the integration proposal or the partnership option is sufficient to offset the increased tax burden. If abuse is so flagrant that the present system could not be retained, or if this seriously distorts the intent of the entire tax package, then we would

propose that a system be adopted where the need of small business for expansion capital is recognized.

That, sir, is our summary of the brief.

Senator Phillips (Rigaud): Mr. MacFadden, I would like to put the following to you: in your capacity as Vice-President, Finance, of National Sea Products Limited I think you concurred in the view expressed by Mr. Connor as spokesman that the integration system proposed by the White Paper is unsatisfactory.

In your capacity as President of the Atlantic Provinces Economic Council you seem to take the contrary view. Am I right in the differentiation?

I can understand the differences because of different qualities in your personal position, but I would like to get that point cleared up first.

Mr. MacFadden: As President of the Atlantic Provinces Economic Council, speaking for the Council overall and the committee on the White Paper on Proposals for Tax Reform, this has been their considered view in general.

I would like very much to have our economist speak to this point.

Senator Phillips (Rigaud): Yes, but before we ask him so to do I would like to direct a further question to you.

Having made the statement supporting the general principle of integration, and I am not critical of your observations, I find a very strong position taken by you with respect to the treatment of small businesses and capital gains, more particularly in respect of valuations.

I wonder if your Chief Economist, Mr. Parks, would be good enough to indicate to us, if small businesses are to receive special treatment and if capital gains are to be treated in a different form, how much have we left of the capital gains system?

The Chairman: You mean how much have we eroded?

Senator Phillips (Rigaud): How much have we eroded, yes, depending upon how much we have left and how much we have eroded. Will you, Mr. Parks, in taking over help us out on that point?

Mr. A. C. Parks, Chief Economist, Atlantic Provinces Economic Council: On the matter of integration in the personal and corporate income tax systems, as Mr. MacFadden suggested, the council views this particular proposal with accord, basically on the principle of equity and in the belief I believe expressed by the council, that this would not seriously interfere with the whole process of development. We must have some kind of balanced structure between the principle of equity in the tax system and the principle of economic development.

Senator Phillips (Rigaud): If the chairman will allow me to make one point, we as senators are also against sin, and in favour of equity. In putting the question to you, I do not want you to feel that we are pressing the point that I, for one, or others are against equity.

Mr. Parks: I appreciate that, sir. I think this was the view expressed by the board of governors of the council. There is, however, one point that we might mention on integration of the two tax systems. It has to do with the proposal to tax unrealized capital gains. We feel this is likely to have a detrimental effect on the whole process of investment for purposes of overall development.

The Chairman: Mr. Parks, on that very question, the White Paper proceeds on the basis that a capital gains tax of 25 per cent may have the effect of locking in investors. We had a description of that situation here from Richardson Securities, in which they suggested that there are different types of investors; there are some investors who look for growth, who are ready to speculate, who will move along and hold the securities they buy, which are of that character, and when they reach a level where they may be getting into the area of investment they sell them and that capital is returned to the capital market, and they repeat the process on the way up again. This is the way a lot of capital is secured in succession for extractive industries and anything that has growth. The White Paper recognizes the potential of locking in an investor by reason of the rate of capital gains tax. Therefore, if you read the paragraph dealing with five-year revaluation, the White Paper says in effect that this five-year revaluation is to unlock those who are locked in; but if they are locked in, they are locked in by the process that the White Paper proposes. If you remove the five years, if I take the judgment of the White Paper you have locked in a very substantial amount of capital investment that might otherwise be available to the market.

Mr. Parks: Yes, sir. This is one thing that does bother me, the locking in effect that I think is inherent in the proposals.

The Chairman: That could be corrected by a lower rate of capital gains tax, could it not?

Mr. Parks: Yes. I do not think from the point of view of the two principles I have mentioned it makes that much difference whether capital gains are included in income and taxed or whether they are taxed separately as capital gain.

The Chairman: I am glad to hear you say that, because if they are taxed separately, then senator Phillips' question was, what is left? The column has shrunk very considerably has it not?

Mr. Parks: That is correct.

The Chairman: Would it be viable then?

Senator Everett: How does the taxation of capital gains—

The Chairman: Will you let him answer this question first?

Mr. Parks: The whole principle of integration would be certainly eroded.

Senator Everett: Could you tell me why? You are talking about the taxation of capital gains on shares of widely held corporations.

The Chairman: I was talking about a special rate of capital gains.

Senator Everett: I think the witness was referring to—

Mr. Parks: No.

The Chairman: He was answering my question, which had to do with taking capital gains tax outside the area of income and having a separate tax. I took his answer to be in relation to that question.

Mr. Parks: That is right.

Senator Everett: Then let us talk about separating the tax from income. How would that affect integration?

Mr. Parks: If a separate capital gains tax is imposed, it is a tax on capital gains as such. I think they have this in the United States. This, of course, is contrary to the proposal of the White Paper, which would include capital gains in income and tax the capital gain as a part of income at the marginal rate of taxation. This element of integration has gone. This is the point I was making a moment ago.

Senator Everett: It is a very good point. Now let us deal with the element of integration that refers to corporate income. Would a separate capital gains tax affect that element of integration?

Mr. Parks: You are referring to a situation where dividends from widely held corporations are included in income and taxed at the marginal rate.

Senator Everett: That is right. The concept of integration says that the payment of corporate tax is, in effect, a form of pre-payment of a portion of the personal tax. If you separated out the capital gains tax so that it was not a part of the income tax, you are then left with that element of the integration system which is the tax on corporate income as it applies to the tax on personal income. I am asking: would that not be viable at that point?

Mr. Parks: You still have this element of integration remaining.

Senator Everett: And that would be workable?

Mr. Parks: My unconsidered answer is that I think it would be.

Senator Carter: On page 11, about half-way down the page, you say:

> Although we accept the principle of drawing capital gains into income for tax purposes, and although we believe this system has more merit than one similar to that of the United States where an income tax and a capital gains tax are two separate systems . . .

Could you give the reason why this would have more merit than the United States system?

Mr. MacFadden: I would like to involve my colleagues here, if I may, and ask Mr. Boyle if he would answer that question.

Mr. A.L. Boyle, Economist, Atlantic Provinces Economic Council: I have to draw this out again,

because I know it is obvious, but I think it is important to recognize that the tax system must of necessity in a society and economy such we live in today must attempt to meet what are almost two mutually exclusive principles and objectives. One is equity and the other is, say, adequate provision for economic growth so that not only do you make the pieces of the pie more equitable, but you also make sure that the pie does not stop growing in the first place.

I may be contradicting myself or someone else but I think that if you are going to have an equitable tax system, then the aim of the proposal for tax reform, and of the proposal that came out of the Royal Commission on Taxation, is that capital gains must, to a varying extent and degree, be drawn into a more comprehensive income base. You still have to draw as many dollars into this income base without eroding the possibilities for economic growth.

The Chairman: If you erode by taking out the capital gains tax out you have eroded substantially the money base which has to feed into this grossing up and integration of income. Overall, the proposals in the White Paper estimate that there will be a reduction in the tax revenues by reason of the grossing up and integration of income. How much more will that minus figure be if you take out of it both the capital gains and the five-year revaluation?

Mr. Boyle: Do not get me wrong. As far as the five-year revaluation is concerned, we have one stand and that is no.

The Chairman: Address yourself to the other question. How much is that minus figure, the loss of revenue which is estimated, likely to be increased if you narrow the money base by taking out capital gains?

Mr. Boyle: I cannot answer that.

The Chairman: Would you agree it seems logical that the minus figure would likely increase?

Mr. Boyle: The aim of a tax system to generate revenue for the Government–it is in part, yes.

The Chairman: I felt that was the chief purpose.

Mr. Boyle: To meet the means of society, but equity is another principle that cannot be ignored.

The Chairman: Perhaps we should have a definition of equity. Equity in taxation might be something entirely different from the concept of equity in the courts.

Mr. Boyle: If equity is defined as ability to pay, then I think you should be drawing capital gains as the general. . .

The Chairman: Let us take your definition that equity is ability to pay.

Mr. Boyle: That is a very crude definition.

The Chairman: How does that enter into the consideration of this question? What we are trying to establish is whether or not the grossing up and integration of income concept is eroded and, if so, to what extent. If you take the capital gains tax out of that system and also take out what you agree should be taken out, the five-year revaluation, would you agree that a small business should be in a separate category with a special rate and have all its own terms and conditions?

Mr. Boyle: It is dangerous to say that small business should have a special rate and be put in a category by itself.

The Chairman: Do you not subscribe to the 21 per cent for small business?

Mr. Boyle: The important thing to realize is that we supported the principle of the dual corporate tax rate. This principle is that small growth businesses must have some resource to meet the challenges with which they are confronted in the capital market. They face a limited availability of funds.

The Chairman: We are then in agreement with what must be provided to small businesses, the right to retain as much of their earnings as possible. And the only way they can do that is by reducing the rate of corporate tax.

Mr. Boyle: Not necessarily. In our brief we suggest that one way of meeting the principles that were established when the dual tax rate was originally brought in would be for legislation to adopt a system of accelerated capital cost allowances.

The Chairman: There are many small businesses such as the Retail Hardware Association, and capital allowances will not do anything for them. You have

to have depreciable assets as a basis for any capital cost allowances, and inventory is not of the depreciable class.

Mr. MacFadden: Mr. Chairman, I think he was just going to say that it did not apply to all of them.

The Chairman: I am saying that a capital cost allowance does not meet the need of all small businesses. If you are looking for a simple principle then I would suggest a lower corporate rate.

Mr. MacFadden: I would like Mr. Parks to enlarge on that.

Mr. Parks: Mr. Chairman, the important principle that we are concerned with is the small growth business or the small business with growth potential providing this particular type of business with funds which can be used for purposes of investment and to assist in promoting the overall growth of the region. If this is possible, it can be done through the retention of low rates on the first $35,000 of corporate income. This can be done despite all the abuses we have heard of.

The Chairman: If I assume you have $35,000 of earnings and pay 21 per cent, you have retained an extra $10,000 a year. For a business of that size, $10,000 a year would be substantial and would also afford some measure of credit

Mr. Parks: The important thing is that these funds are increased and not added into income.

Senator Phillips (Rigaud): I would like to direct my questioning to either Mr. Parks or Mr. Boyle. We have had the advantage that you have not had of hearing a mumber of submissions. Some of the assumptions I am about to put to you are based on that advantage we have had. We are not here to embarrass you or to disagree with your concepts of integration; we are here to be guided by you and to get the benefit of your views.

Assume for the purposes of my question that this committee comes to the conclusion that we want to segregate capital gains and apply a special flat rate tax system. Assume further that we feel small businesses must be treated differently in the sense of the lower rate, at least up to the first $35,000 worth of earnings. And assume further that we see no merit in the distinction referred to in the White paper between public companies and priviately owned ones.

Accept those three assumptions for the moment. What do you see by way of merit in the White Paper, of an integration system, as against the present system of a tax credit in respect of dividends declared, not necessarily at the present rate of 20 per cent. It may be increased or decreased, but I am speaking of the retention of the present system, in order to bring about this equity, having regard to corporate tax having been paid, and a credit to be given to recipient shareholders. Could we get some opinion on that score, because we are anxious, we are groping on that point. I am asking you to accept three assumptions. What do vou see in an integration system, left—have we a wraith, have we a ghost, have we meat on the bone, in an integration system, as compared to the tax credits that we now have?

Mr. Parks: Mr. Chairman, I think that the three assumptions which have been made—the segregation of capital gains and the taxing of capital gains at a flat rate, some special consideration to small business, and the elimination of the distinction between public and private companies—those three assumptions, in my opinion, would pretty much erode the whole proposition of integration. And at this point you are back to something of the same system, the same system that we have at the moment, to some kind of special consideration for dividends received from taxable Canadian corporations.

Senator Phillips (Rigaud): Thank you very much. That is what I wished. This will be very helpful to us in our deliberations. I mean, your view.

Senator Everett: Coming back to your suggestion that capital gains must be taxed as part of income, could you tell me, again, why you make that suggestion, why you are opposed to a separated tax?

Mr. Parks: Again, this was a decision of the board of governors of the council. I hate to use this term consistently, this term "principle of equity", but in this case realized capital gains do become a part of income of the individual. So the council subscribed to the view that therefore it should be taxed as part of income.

In my testimony a moment ago, I suggested that, from a purely personal point of view, this same objective might be obtained through a separate tax on gains, as opposed to the integration of the system.

Senator Everett: Following that on for a moment and dealing with the concept of equity, I think you

stated in your brief that the idea of drawing capital gains into income becomes inequitable under the White Paper unless there is a very great change in the income averaging provisions. Is that not so?

Mr. H. J. Flemming, Executive Vice-President, Atlantic Provinces Economic Council: Yes.

Mr. Parks: Well, I think the main point on the income averaging principle is that—well, I will be frank, I do not understand it.

Senator Everett: I think what you state in the paper is that a gain would be taxed at a high marginal rate and a capital loss at a low marginal rate under the present income averaging provision. Is that not so?

Mr. Parks: Yes.

Senator Everett: So you take the attitude that a separate capital gains tax could be as equitable as one which draws capital gains into income?

Mr. Parks: This would be my personal view.

Senator Everett: Mr. MacFadden, would you have a view on that?

Mr. MacFadden: Yes, I would have a view on that and I would think that that could very well be so, for a direct tax on capital itself rather than bringing the capital gains in as part of taxable income as we know it today, that a method could be developed that would be equitable and fair.

Senator Everett: And would not have the defect of requiring special income averaging provisions.

Mr. MacFadden: I would agree with that.

Senator Everett: Can you tell me, Mr. Parks, how separating capital gains tax destroys the concept of integration under the White Paper?

Mr. Parks: I do not think I used the word "destroy".

The Chairman: "Erode".

Mr. Parks: I used the word erode.

Senator Everett: Perhaps you would like to tell me then how it is eroded?

Mr. Parks: This particular principle of integration has gone but you still have integration of the personal income tax, you still have your income from dividends of widely-held Canadian corporations included in income. You still have this element of integration, as you do at the moment.

Senator Everett: Perhaps you could be more specific than that. What do you mean when you say that a separated capital gains tax will erode the concept of integration?

Mr. Parks: What I said, on the term integration—again, like Mr. Boyle, I hate to use the term "a buck is a buck is a buck" but this is essentially what we are talking about.

Senator Everett: In a sense, we are not, because we are talking about a separated capital gains tax.

Mr. Parks: But we are talking about why discourage integration.

Senator Everett: Yes.

Mr. Parks: As I understand integration, it is adding into income, it is the inclusion in income of all sorts of earnings, whether they are earnings as wages and salaries, earnings as dividends, earnings from capital gains, or what have you. You have an integrated income package.

Senator Everett: I am afraid that is not what I understand as integration and perhaps we are falling down on semantics.

Mr. Parks: I think there is another element to it. There is this element of integration, and there is the integration of this with the corporation income tax.

The Chairman: Senator Everett, you could easily get into agreement on what "integration" means.

Senator Everett: I was about to do that.

The Chairman: By asking what does the White Paper include under the descriptive wording "integration of income".

Senator Phillips (Rigaud): I suppose we could start off with a negative, that "integration" does not mean what people in the southern United States say it means.

The Chairman: Yes.

Senator Phillips (Rigaud): And then we could move on from there, to see whether we can get something.

Senator Everett: On that basis, I wonder if we could talk about integration as that concept that relates to tax paid by a corporation and tax paid on the income derived from the corporation by its shareholders. Could we talk about it on the basis of that concept rather than on the basis of the concept you have been referring to apparently, where you believe integration is the bringing in of all income? I think you have been answering Senator Phillips' (Rigaud) questions along that line. I should like to shift the emphasis a little to my definition.

The Chairman: But is your definition the definition of the White Paper?

Senator Everett: We will leave that to the tax expert here, Mr. Gilmour.

The Chairman: Where are you putting the capital gains?

Senator Everett: We can ask Mr. Gilmour.

Mr. Gilmour: What Senator Everett said is the White Paper definition of integration, namely, integrating the corporate income tax with the tax payable by shareholders on dividends paid to them, and I don't think the definition goes beyond that; although, inasmuch as capital gains are to be subjected to corporate income tax, then to that extent it falls into integration.

The Chairman: Mr. Gilmour, you are separating then the words which are used; that is, grossing up. What connotation do you give to that? Grossing up and integration? Don't you have to put the two together? Isn't there a plus sign there?

Mr. Gilmour: It is the same thing.

The Chairman: Grossing up would give you room to bring in your capital gains as income.

Mr. Gilmour: Grossing up applies to the dividends paid, Mr. Chairman. If there were a capital gain earned by the corporation and taxed in the hands of the corporation, ultimately that income would go out as dividends, and then you gross up the dividends either by 100 per cent for the closely-held or 50 per cent, but I do think integration restricts itself to corporate tax and dividends paid. But, of course, as you have been questioning here, if capital gains are not brought into the concept of income, then our whole integration system will start to vibrate a little. It may shake itself apart.

Senator Everett: We have now the definition of integration.

The Chairman: And the shakes.

Senator Molson: And the erosion caused by the shakes.

Senator Everett: Would you care to tell me how the erosion takes place, Mr. Parks?

Mr. Parks: As I understand the definition, there is an element of the capital gains tax.

Senator Everett: The element of the capital gains tax, I believe, is the capital gains tax that is paid by a corporation on which tax is paid, and it can be grossed up and passed out to the shareholders. I don't think that that is a very serious element in relation to the capital gains that would be paid on the shares of a corporation. So I think we are really dealing with the capital gains on the shares of the corporation.

Mr. Parks: If you have a special capital gains tax and if the individual shareholder—and I presume that I am right—if the individual shareholder takes a credit for that part in the capital gains paid by the corporation, then there is still an element of integration here.

Senator Everett: I think we can deal with the separate capital gain on the share itself. Do you think that that would affect the concept of integration and, if so, how? Would it erode it?

Mr. Parks: Mr. Chairman, I really have not thought of this question, and I don't know that I should attempt a sort of definitive answer here. My own feeling is that once you begin to move the things around you then begin to erode the whole principle of integration as defined and as implicit in the various proposals of the White Paper. I am not saying this is bad.

Senator Everett: I don't think anybody would argue that as a general principle, but are you saying that you are not able at this stage without further study to say how this erosion takes place?

Mr. Parks: On a detailed basis I am not able to at this point.

Senator Everett: I will not press the matter. Thank you, Mr. Parks.

The Chairman: In the light of the discussion that has gone on, Mr. Parks, do you think there should be some qualification of the statement on page ii of the brief of APEC, which I will now read:

> The aim of establishing a degree of integration between the personal and corporate income tax system we view with general accord.

Are there any qualifying words that we should put in there in view of the discussion we have just had, or do you still want it to stand unqualified?

Mr. MacFadden: He says, "Let's ask the President". My reaction to your question, sir, would be that what we are trying to say—and perhaps we are not doing a good job in saying it—is that we are not arguing with the geneneral principle. The general principle may be all right. We don't know. We are not tax experts. We are an economic council. We stand back and we say that as economists we feel it may be all right, but that—and then we go on to list our "buts". We are not in great disagreement with the general principle. It may be all right.

The Chairman: But when you express approval by saying you view this with general accord, that is an opinion that you have expressed, and opinions depend for the weight that you give to them on what are the reasons supporting the opinions. Have you made a study of this in depth that would enable you to express this opinion?

Mr. MacFadden: We have made a study, yes. I would say we have done one in depth, sir. Once again it is a question of degree. What is "in depth"? We may not have done a study in depth sufficiently for the knowledge and experience which the Senate committee has had to date. There may be others who have made better studies in depth. But this is our esteemed effort.

Senator Phillips (Rigaud): If I may have a word, Mr. Chairman, may I say before we conclude this hearing that I for one am left not in a state of confusion but in a state of indecision. But that is due to the complexity of the problem with which we are dealing. In the early part of the morning we listened to a very important brief from a very important company in which we had the right, I think, to come to the conclusion that the recommendations of the White Paper, if implemented into law, would seriously affect parts of our country which are accepted as being regionally depressed. Then, when we listen to this brief . . .

The Chairman: The APEC brief.

Senator Phillips (Rigaud): . . . we don't seem to get that impression. If we do not get the contrary impression, we do not seem to get a confirmatory impression of at least my tentative conclusions flowing from the brief of National Sea Products Limited. That could be due, Mr. MacFadden, as I said a moment ago, to the complexity of the thing. God knows that the experts disagree on taxation. When the experts on taxation come to a disagreement, the only comfort they can derive from the situation is that they realize the economists seem to disagree more than do the tax experts. That is of some comfort to those of us who seem to be somewhat knowledgeable in the field of tax law. I just want you to know that I am left not in a state of confusion but in a state of indecision.

Mr. MacFadden: I must say, Senator Phillips, that I concur to a certain degree with what you say. I can assure you that I have the same problem as you. Today I am here as President of the Economic Council, which, as I mentioned, is composed of people of all walks of life within the Atlantic region—business people and others. Basically it is an economic council, and it is on that basis that we have made this study; and our approach is that this will generally affect the economy and the social development of the Atlantic region. Now in this brief we endeavoured to stay away from the approach to specifics, because we do not feel qualified to get into specifics as one would if one were a tax expert or had the facilities of a tax expert.

The Chairman: But, Mr. MacFadden, you are head of APEC which has for its purpose the improvement of economic conditions in the area in which you operate, and then we find that a business that is operating in that area like National Sea Products, comes in and tells us that integration in relation to a growth business is not desirable. Then you come in following them and tell us that you view the provisions on integration with "general accord". Now a large segment of industry, and National Sea Products constitutes a large segment of industry in the Maritimes—I think it is correct to say that by "general accord" you mean you are generally in accord with integration, and you are not speaking in your capacity as president of an organization which

has the job of stepping up the economy in the whole Maritime area.

Mr. MacFadden: I only wish that we had, instead of using the words "general accord", said that we do not dispute or disagree necessarily with the provisions. This is the way I would read "general accord".

The Chairman: But it certainly can be read as we have been reading it, that is that generally you are in accord with integration. There seems to be some gaps there.

Mr. MacFadden: I think I will let Mr. Parks speak to this, if I may.

Mr. Parks: Mr. Chairman, I think that I should again emphasize the point that Mr. MacFadden has emphasized, and I should do it very strongly. But we have not looked at it from the point of view of tax experts or what it means in terms of the day-to-day implementation of various tax laws. We have looked at it from the point of view of the possible effects of the principles inherent in the White Paper on the whole process of economic development, particularly in the Atlantic provinces. This is the sort of point of view from which we approached this, and our general conclusion was that the proposals as presented, with exceptions which I shall mention later, while serving the principles of equity, would not seriously interfere with the process of economic development in the Atlantic provinces.

Now, those exceptions are the taxation of unrealized capital gains and the others which Mr. MacFadden read in his summary statement this morning—to the fact that assets purchased or that part of assets purchased with funds obtained as a grant towards capital costs as an incentive to the Department of Regional and Economic Expansion are not depreciable—that we felt would have a depressing effect on the economic development of the Atlantic provinces.

Mr. MacFadden also mentioned in his summary statement that there are examples of growing businesses, and you heard this morning a presentation from one of the large growing businesses that nothing should be introduced into the tax system which would discourage private investment in growing business with large depreciable assets. As I say, the submission you heard this morning was from one company which does have this particular problem. We also mentioned the problem of private utilities and Mr. MacFadden read it into his summary statement, and other areas of economic activities. While agreeing in general, there are certain specifics not in the complex tax field necessarily, but in the application of the principles which might have a deterring effect on the whole process of development, and these we have attempted to isolate as much as we could.

The Chairman: Yes, Mr. Parks, but in a growing developing company, and where they have substantial capital cost allowances and special accelerated write-offs, they have a good cash flow from that. But when they pay a dividend to shareholders, the shareholder does not get the benefit of the creditable tax. Now, if this is something that is objected to and is detrimental to the business in your area, I am just considering the connotation that we should give to the words "general accord".

Mr. MacFadden: Mr. Chairman, speaking to the creditable tax, where we say that we urge that these matters be given every consideration with a view to fair treatment of all shareholders, I think it is not unreasonable to say that it may help senators to understand the presentation from the Economic Council to say that if there was a group of businessmen making a statement, they would hire tax consultants and we would make a very definite positive drive as a company might do. In this we are reading it in a general way and we hope you will read this into it, because we are saying it there.

The Chairman: We will read these with the qualifications that are there.

Senator Carter: Mr. Chairman, I am slightly disturbed about this. Is it fair to interpret what you have said in your brief and what you have said by way of comment in reply to question that generally speaking the White Paper proposals will not retard development of the Maritimes, but that there may be exceptions, and that National Sea Products and utilities are exceptions which may be heard, but that these are exceptions which would not apply to the economy of the Maritimes generally?

Mr. MacFadden: Oh, I would not say that. I hope you would not take that meaning. That is quite to the contrary. We are saying that all these things that the companies have been saying and that we have touched on here in the brief—and maybe we have not been sufficiently clear—

Senator Carter: But you give general approval to the White Paper?

Mr. MacFadden: In the same sense that we are all in favour of motherhood, to use the old expression, but then we go on to introduce the "buts" and we would like you to read these "buts". We say that if you are going to change the low tax rate for the small businesses, then you have to find some other way of giving them relief. We do not say what that other way should be because we do not pretend to know. We do not pretend to be experts. But we say that from an economic and social point of view, it is going to affect the Atlantic provinces if you do not find another method of giving them relief which they received under the dual tax rate.

Senator Molson: Mr. Chairman, I would like to ask Mr. MacFadden if he believes from the point of view of the economy of the Atlantic provinces that we can have rates of income tax as proposed in the White Paper without any possible loss of valuable people—that is valuable people going from the provinces to the United States? Can we disregard the levels of taxation in the United States as compared to those in Canada?

Mr. MacFadden: We have treated that in our submission to you, and we have said that the Government must be very careful that they do not develop a tax rate that involves a lack of incentive to people to stay in the Maritimes or the Atlantic provinces; otherwise we are going to lose them. We are saying that this is a point that must be watched very carefully.

The Chairman: But, Mr. MacFadden, saying you must watch it, we have had evidence before us which shows that on a comparative basis the rates proposed in the White Paper produce a higher impact of taxation on individuals than the rates presently existing in the United States.

Senator Molson: Particularly in the lower income brackets. My specific question to you was: Can we afford to have a scale of income taxation that disregards the levels in the United States?

Mr. MacFadden: No. Once again as we say in our brief, we definitely cannot afford to. It is a very serious point.

Senator Molson: I agree. I would like to go on from that, if I may, Mr. Chairman, to deal with capital gains, in exactly the same way. Do you think that capital gains in Canada should be treated so that they attract greater taxation than they would in the United States, or the same, or less? I am speaking of the rate here, not whether it be included in income.

Mr. MacFadden: I would certainly hope they would attract less than in the United States.

Senator Molson: Less, if possible, than in the United States?

Mr. MacFadden: Yes, I would hope so. Then, in reverse, there should be incentives to stay in Canada; we need incentives.

Senator Molson: If we could find one, yes.

Senator Burchill: Mr. MacFadden, I was just wondering whether you stressed enough the number of people we are losing from the Maritimes, not only to the United States but to other parts of Canada, on account of the economic conditions.

Mr. MacFadden: APEC has said it so many times, over and over and over again, over the years. Maybe it should have been said again, senator.

Senator Burchill: You cannot say it too much.

Mr. MacFadden: No, you cannot say it too much; you are probably right.

Senator Everett: Mr. MacFadden, coming back to this concept of integration and your comments on it, and dealing with it in a general sense but on the basis that it is perhaps a credit for corporate taxes against personal taxes, would you say that you support the concept of integration, but that if through the tax dividend credit method mentioned by Senator Phillips you were able to achieve integration—

Mr. MacFadden: What was the method you mentioned, senator?

Senator Everett: The tax dividend credit, which is our present method.

Mr. MacFadden: Yes.

Senator Everett: —you achieved what you hope for, which is integration, and you would also not have to have the defect mentioned by National Sea Products of tax incentives not being available to the shareholder because they do not create creditable tax, would you agree with that statement?

Mr. MacFadden: That is a pretty long statement, senator.

The Chairman: Or a question.

Mr. MacFadden: Yes, or a question. Could I answer you by saying that I would very much prefer to see the present system retained, and I think it would continue to be beneficial to the Atlantic region and the businesses of the Atlantic region? I would be very much afraid of the proposals of the tax in the White Paper. Does that answer your question?

Senator Everett: I think it does, but I might want to break down the elements a little. You are in favour of the concept of integration generally, but you are concerned, as National Sea Products is, about the non-creditable tax on corporate tax incentives.

Mr. MacFadden: Yes, and so is APEC.

Senator Everett: If, as Senator Phillips suggests, a tax dividend credit system could be amended to create integration, or what is next door to integration, this would answer all the problems of APEC?

Mr. MacFadden: Yes. Once again, there is an area there: if this could be done. I think there is great concern over what is going to be done and how the things are going to be implemented. If these things could be done, yes, I think the tax credit system is the best system.

Senator Everett: Would there be general agreement among your directors on that point—and your economists?

Mr. MacFadden: In an economic council, you have this problem—

The Chairman: Are you going to poll the jury?

Mr. MacFadden: —of the businessman or the medical doctor who is interested in—I almost said "politics". You have the great cross-section; you have not one little group thinking all the same way, and this is the problem of presenting a paper like this.

The Chairman: Of course, the real difficulty arises, as Senator Everett was pointing out, when you tie in the corporation tax paid as part of your integration, and the creditable tax only comes where there has been corporation tax paid. The question is: Is that a sound principle? They did have this system in England, and they abandoned it in 1965. There are different views as to why they abandoned it, but I think the main view was that the Chancellor of the Exchequer in England felt it was not producing enough revenue and, therefore, he went back to the old system of corporation tax and then regarded the dividends when they went out to the shareholder as just being income of the shareholder, the same as any other money he got, and being subject to tax at his rates. If you read the budget speech of, I think it was Mr. Callaghan who was the Chancellor of the Exchequer at that time, and then read the reports on this, this was the basis of it, the complexity of integration and, secondly, that it was not yielding enough revenue.

Admittedly, on the figures we have in the tables in the White Paper, it is producing a minus amount of tax revenue as far as the Government is concerned, so we have to look pretty hard to find the virtue in it—or perhaps I should put it this way, that we should look very hard to see where the virtues are.

Senator Phillips (Rigaud): Mr. Chairman, before the group leaves, may I introduce some balm into the discussion by assuring them that there will be diversity of opinion among the senators on the subject matter?

Senator Molson: Mr. MacFadden, if in the course of events the principle of capital gains being incorporated with income for taxation purposes did not apply, would you have any objection to the top rate not then being at 50 per cent but perhaps somewhat higher? I am speaking, of course, of personal income tax.

Mr. MacFadden: I would want to think about that one a little bit, senator. Agreeing to tax rates being higher, under any circumstances, is a very difficult thing.

The Chairman: That is a good qualification.

Mr. MacFadden: I would want not only to be sure, but to be positive.

Senator Molson: It has been suggested that if that source of revenue at that rate were removed there would have to be some offsetting compensation, and it has been suggested that would probably mean that the top rate could not stop at the even 50-50.

Senator Carter: As an economic council in the Maritime provinces, have you ever developed any

yardstick for measuring or defining a small business, a large business, and a medium sized business?

Mr. Parks: As a Council we have not developed any definition of a small business or a large business. I think there is a generally accepted definition of a small business, but at the moment I forget what it is.

Mr. MacFadden: Senator, we have not defined a small business as such.

The Chairman: Would you accept the principle of defining small business by the amount of its net profit?

Mr. MacFadden: Speaking taxwise, I would be inclined to agree with that.

The Chairman: So it becomes a question of whether the definition of a small business is that it is a business which has net profits of not more than $50,000, or not more than $75,000, or not more than $100,000?

Mr. MacFadden: It is a business with net profits of not more than X dollars?

The Chairman: Yes.

Mr. MacFadden: I would be inclined to agree with that.

The Chairman: Then, thank you very much, Mr. MacFadden.

Mr. MacFadden: Thank you, Mr. Chairman.

The Chairman: Honourable senators, we shall now consider the submission of the Co-operative Union of Canada. Mr. Melvin is the president.

Mr. W. B. Melvin, President, Co-operative Union of Canada: Mr. Chairman, I have with me Mr. M. J. Legere, the Director General of La Federation des Caisses Populaires Acadiennes Limitee.

The Chairman: Yes. I will ask Mr. Legere to come forward as well.

Mr. Melvin will make an opening statement on behalf of the Co-operative Union of Canada, and Mr. Legere will follow him.

Mr. Melvin: Mr. Chairman and honourable senators, as has been indicated, I have the honour of being President of the Co-operative Union of Canada which, if I may, I would like to refer to as the CUC for the sake of brevity. It is a custom that we have, and it seems serviceable.

May I introduce my colleagues from the CUC. First of all, there is Mr. William Bergen, who is the Treasurer of Federated Co-operatives Limited in Saskatoon; Mr. Ed Chorney, Treasurer of United Co-operatives of Ontario; Mr. Joe Dierker, who is our solicitor and who resides in Saskatoon; and Mr. Terry Phalen, who is our General Secretary.

Mr. Legere will make a brief statement, and he will introduce his colleagues who are with him.

Mr. Chairman and honourable senators, as has been indicated, I have the honour to be the President of the Co-operative Union of Canada which I shall refer to in this discussion as the CUC.

I am pleased that my colleagues and I, are joined in making this submission on the Proposals for Tax Reform by Le Conseil Canadien de la Cooperation. I shall refer to our sister organization as the CCC, and am happy that the President of the CCC, Monsieur Martin Legere, of Caraquet, is present to offer comment on behalf of his organization.

Mr. Chairman and Honourable Senators, may I say for M. Legere and myself, the members of our delegation, and for the organizations we represent, that we appreciate the privilege of discussing with you the Proposals for Tax Reform and the implications of the proposals to co-operative organizations. I would add that although our interest in the White Paper embraces its implications for all sections of society, we have confined our comments to its effects upon co-operatives, an area in which we believe we may speak with greatest competence.

The Economics Branch, Canada Department of Agriculture, reports that in 1967 there were 2,519 co-operative organizations in Canada. These 2,519 individual, autonomous organizations were engaged in such activities as marketing and purchasing, production, fishing and providing services to a membership totalling 1,688,000 Canadians. This does not include members of Caisses Populaires and Credit Unions. We do not propose to speak for these organizations whose central federations, have also submitted briefs to your committee and will appear before you later today.

Senator Phillips (Rigaud): Mr. Chairman, may I interrupt? I would ask Mr. Melvin if he would be good enough to speak a little more slowly, because I think we have difficulty in absorbing everything he is saying.

Mr. Melvin: I apologize.

Senator Phillips (Rigaud): Not at all, but we want to follow you.

Mr. Melvin: I would like to point out that this figure does not include members of Caisses Populaires and Credit Unions. We do not propose to speak for these organizations whose central federations have also submitted briefs to your committee, and who will appear before you later in the day.

A co-operative is an organization that is owned and controlled by the members to whom it renders service, and has as its chief aims the lowering of the cost of that service to the members. It is not an aim or purpose of co-operatives to generate reward on capital invested by members. Shares held by members are non-speculative and non-transferable and hence reflect only the responsibility of each member to provide for a portion of the capital requirements of his co-operative. The member joins voluntarily and shares in the control of the co-operative through the exercise of his one personal vote. Surpluses or savings, realized on the operation are returned to the members on the basis of their individual patronage of the enterprise.

Permit me, Mr. Chairman, briefly to outline the White Paper Proposals as they are understood by our co-operatives.

Paragraphs 4.70 and 4.71 of the White Paper propose that co-operatives "continue to eliminate taxable income by a combination of patronage dividends and interest to members". Furthermore, this provision imputes a rate of return on the members' investment before determining and allocating patronage refunds to the members.

In our brief we take exception to the proposals in the White Paper which impute a deemed return on capital employed for the following reasons:

1. The proposals appear to require co-operatives either to abandon or to distort the application of traditional co-operative philosophy, principles and methods, which have determined the characteristics and practices of co-operatives the world over.

2. The proposals appear to be in conflict with provincial co-operative legislation.

The proposals respecting co-operatives do not take into consideration the revolving nature of co-operative capital and the difference in nature between it and the capital of a private or investor-owned corporate enterprise.

The requirement that interest be paid on members' share capital intrudes upon the traditional right of members to control their co-operatives. Furthermore, it is a principle of co-operatives that any payment for the use of capital shall be modest and limited. Compliance with this requirement would seem to compel co-operatives to violate statutory regulations or by-law provisions restricting the rate of return to capital.

Our concern, then, rises from the dangers that we see in applying the proposals to co-operatives rather than from opposition to tax reform. This, I believe, is made evident by the fact that we have included in our submission an alternate proposal with respect to taxing co-operatives. We strongly urge adoption of the alternate proposal that we have presented.

Your committee will be aware of the plight of Canadian agriculture and the importance of diversification in which process co-operatives play an important role, as a means of increasing farm income. We would point out, also, that co-operatives are truly Canadian-owned enterprises which can contribute to the strengthening of Canadian economic independence.

Our submission also directs attention to the need for a definition of "capital employed" as related to co-operatives. We have examined two possible concepts of the term and find that neither one is logical nor consistent in relation to the tax proposals. Thus, our assertion that the tax proposals respecting co-operatives were conceived without adequate knowledge of co-operative enterprise and its financing, appears to be well founded.

Our brief examines many procedural difficulties that would face both the revenue officials and the co-operatives under the White Paper proposals and concludes that the proposals should be carefully re-examined from both points of view since they would prove unworkable in practice.

We have also related co-operative enterprise to the concepts of closely-held and widely-held corporations. We have pointed out, in our submission, sound and logical reasons why neither category is appropriate to co-operatives. Our deliberations have led us to the conclusion that in addition to the closely-held and widely-held categories, there is need for a third category which could be termed "co-operatively-held". This designation, we suggest, would give expression to the significant differences existing between co-operatives and other forms of enterprise.

Our proposal is that co-operatives be permitted to deduct all distributions made, whether by way of return on member investment or as a patronage refund, in arriving at taxable income, with all surplus earnings not so distributed being taxed to the co-operative at the collective rate of tax.

This proposal has several merits. It is simple. It complies with the principle of the White Paper which is to tax income only once, and it conforms to the proposal of the White Paper that co-operatives should be able to eliminate income by transferring it to members who will then deal with it individually as to its taxability in their hands. In addition, our proposal recognized the distinguishing characteristics of co-operative enterprise.

With your permission, Mr. Chairman, may I now call upon M. Légère to speak on behalf of Le Conseil canadien de la Coopération.

[*Translation*]

Mr. Martin, J. Legere, President, Le Conseil canadien de la Coopération: Mr. Chairman and Gentlemen: First of all, I wish to thank you very sincerely for inviting us to come and meet you so that we can give you our opinons on the White Paper's recommendations concerning co-operatives.

It is my pleasure to introduce to you our official delegation: first of all, Mr. A. Morin, economist for the *Fédération des Caisses populaires Desjardins du Québec*; Reverend Father E. Bouvier, s.j. who holds the chair on the Co-operative Movement at the University of Sherbrooke; Mr. Y. Daneau, Director of the *Conseil de la coopération du Québec.*

As representatives of the co-operatives, we believe it is our duty to propose, with regard to net overcollections arising from their operations, taxation that will be in harmony with the nature of co-operatives and also with the general spirit of the White Paper.

Although we are confining ourselves to the general principles of the federal government's White Paper, we think that it would have been enough to stipulate that the money distributed to the members by a co-operative should be included in the income of the recipients, while the retained overcollections would be taxable in the hands of the co-operatives.

That is the attitude of the Canadian co-operative movement to the proposals in Mr. Benson's White Paper. Our point of view is contained in the brief that we are submitting to you today. We want to point out that this brief is being submitted jointly by the Co-operative Union of Canada and the *Conseil canadien de la co-opération*, bodies that according to the latest federal statistics, those for 1967, include 2,519 organizations and 1,688,000 members excluding those in the savings and credit unions.

What the co-operatives have always demanded and continue to demand is to be recognized for what they are in a tax system and to be treated as such. Co-operatives do not now, any more than in the past, demand total tax exemption, but do demand equitable treatment.

Our Canadian co-operative organizations acknowledge the intent of the White Paper to make specific proposals for co-operatives, but we conside them unsatisfactory. The proposal was in fact formulated without taking into consideration the basic principles of co-operatives and even goes against the rules by which we are governed. Also, we believe that the proposals cannot be put into practice and should not be given effect in the legislation.

We believe it is the duty of the Canadian co-operative movement to give the Canadian government our own proposal for the taxing of co-operatives, a proposal that combines the White Paper's principle of taxing income only once and the principle which allows co-operatives to eliminate income by transferring it ot the members.

Our main proposal is therefore as follows: that co-operatives be free to deduct all money distributed either as remuneration of capital provided by the members, or as patronage dividends, before arriving at the taxable income; then, that all retained overcollections be taxable in the hands of the co-operative, at a group tax rate. This proposal also provides for the money distributed by a co-operative to the user members to be taken into account by their recipients when establishing their income.

We also demand an addition to the categories of corporations used by the White Paper for tax purposes: this new category would be precisely that of "co-operatives".

The Canadian co-operative movement disagrees with the White Paper when it claims to be able to treat co-operatives and ordinary corporations in the same way and makes assumptions about the yield that a member's investment in his co-operative should produce. We should like to make the following distinctions: in a co-operative, the purpose of the capital

supplied by a member is to permit the member to realize economies that are tied to the use that he makes of the co-operative's services; whereas in an ordinary corporation, the capital is supplied for the purpose of drawing a profit as remuneration for this investment. The same philosphy applies at the time of redistribution of surpluses: the co-operative distributes its overcollections as patronage dividends proportionately to the business done by the members, while the ordinary ccorporation distributes its surpluses in the form of remuneration of the invested capital.

We rightfully stress the characteristics of the co-operative which are as follows: the co-operative exists for the purpose of supplying goods and services to its members. The overcollections from operations belong to its members. When these overcollections are re-invested, it is not for the purpose of a gain, and a member's investment is often unpaid.

It is therefore clear that to treat a co-operative like an ordinary corporation for tax purposes would be to completely ignore the nature and ownership of over-collections and the right to them of the user owners; it would not be equitable.

The White Paper provides for the net surpluses from the operations of a co-operative to be divided among the members. It claims however to dictate to the co-operatives how they will have to carry out the distribution in order to be able to reduce their taxable income.

We find this attitude of financial control disturbing and we affirm that when they act this way they are not taking into account the nature of co-operatives.

In several cases, this proposal would even go as far as to prevent co-operatives from continuing to distribute their surpluses according to the rules of the co-operative movement.

Although our brief criticizes the proposal affecting the distribution of our overcollections, we support the idea of taxing sources of income in the hands of the individual at his personal rate; that is the principle we wish to see applied both to the co-operative and to our members.

The objective of the White Paper is to ensure equitable treatment for taxpayers profiting from ownership in various types of corporations. In this sense, we accept the proposal that corporate income be taxed only once and at the recipient's personal tax rate, at the very time the income would be distributed. However, retained overcollections should be taxable in the hands of the co-operative.

On the subject of the patronage dividends to consumers, we have convinced that it should continue to be non-taxable in the hand of the recipients; considering that this patronage dividend is only a return of part of the purchasing cost of goods for personal use, and that the cost of such goods was not deductible for computing income when they were acquired.

That is the essence of our brief and we hope you will take it into consideration at the time you submit you recommendations to the Canadian government.

We wish to thank you for receiving us and if there are some points you want made clear, we are entirely at your disposal. Thank you.

[*Text*]

The Chairman: Are there any questions? Is there anything that any member of your group wishes to add?

Mr. Melvin: I think our statement is complete, Mr. Chairman.

The Chairman: For purposes of the record, what would it mean to your organization if the White Paper proposal was implemented as against your present position?

Mr. Melvin: In financial terms?

The Chairman: Yes.

Mr. Melvin: I wonder if Mr. Bergen would deal with this.

Mr. W. F. Bergen, Treasurer, Federated Co-Operatives Limited: In financial terms, what it would effectively do would be to destroy the present concept that we have of financing, in that presently the earnings at the end of the year are distributed in accordance with the patronage it has had from the members. Under this concept of giving interest on the share capital or the equity, whichever may be defined, it would mean that we would no longer be able to distribute the patronage refund, because the rates we suspect would apply based on the present farm board rates of 8½ to 9 per cent would be about equal to the earnings or the return on the equity. This would mean that unless the interest which will be paid out under this proposal were allowed to be retained—in other words, allocated to the members but retained by the co-operative—it would mean a complete drain of cash from the organization of the earnings entirely in each year, and the earnings are the only form we have of building up share capital

over a period of time, in that we do not normally go out into the market to finance and sell shares in the conventional sense of the word.

The Chairman: You speak about share capital. Let us start with that. Your co-operative is incorporated. Is that right?

Mr. Bergen: That is right.

The Chairman: Usually provincial incorporation, or federal?

Mr. Bergen: It varies, but usually provincial.

The Chairman: You have a single share capital, all shares of the same class; you do not have preferred shares?

Mr. Bergen: We do in some instances have preferred shares that are sold to non-members of the co-operative. In other words, they are an investment. But this is not the commonly accepted or traditional method of financing.

The Chairman: When members subscribe for shares they must hold a share in order to be a member. Is that right?

Mr. Bergen: That is correct.

The Chairman: Is the patronage restricted to people who are members, or can any member of the general public go in and do business with a co-operative?

Mr. Bergen: Any member of the public can normally come in and do business, but the patronage is restricted to members, unless it is advertised in such a manner that it will be open to the public, but normally it would be the membership.

The Chairman: What percentage of the volume of business that a co-operative would do in a year might be related to non-members' business?

Mr. Bergen: This would vary. Speaking now in terms of the consumer co-operatives, I would suggest that this could be in the order of 15 per cent on a non-member basis. To quite an extent this relates to certain services or products that non-members find it convenient to come to the co-op in order to acquire.

The Chairman: You limited that to consumer items. What other classes of business are carried on by co-operatives?

Mr. Bergen: There are, as was indicated in the opening statement, producers and marketing, and the percentage in this case according to my information for non-member business would be much less than the 15 per cent.

The Chairman: So the greatest impact from non-members would be in the consumer items?

Mr. Bergen: That is right.

The Chairman: When you come to determine your patronage dividends, you have an area of income in which all the members share. When determining what the patronage dividend is to be, you take the sum total of all the business and determine the amount of business that a member did with the co-operative in the year, and that establishes a percentage?

Mr. Bergen: That is correct.

The Chairman: That payment that you make, the patronage dividend, is a deductible item, is it not, from the point of view of tax?

Mr. Bergen: Under present legislation we pay tax on either the non-member business, and the percentage of earnings applicable to that, or the three per cent of the capital employed formula or the earnings retained allocated to the reserve account.

The Chairman: How do you determine the capital employed?

Mr. Bergen: Under the present method, by taking the assets in total and deducting from it certain liabilities. It is not related directly to the shared capital. Under the White Paper concept, as we have been given to understand, it would be related to the equity or the shared capital, but I am not sure which.

The Chairman: Which way would be the most advantageous to you?

Mr. Bergen: This is a difficult question, certainly in terms of looking at it as an investment. If we talk in the conventional sense of the member's investment, then the share capital is the amount that the member has put up and feels he has invested. It is also the amount upon retirement which will be returned to him. Any reserves in a co-operative normally are not returned to the member upon his retiring from membership.

The Chairman: Is the reserve which you set up invested in the operation itself or do you earn income outside of your operation with a reserve fund?

Mr. Bergen: These reserves are set up in the normal sense of the word as reserves on the ballot sheet. In other words, part of the earning is set up as a reserve and not allocated to any specific shareholder. This is by provincial statute. We have to set up reserves in the event we have years where earnings are not sufficient to meet commitments.

The Chairman: I assume the reserve is used to earn money.

Mr. Bergen: It is a part of the capital employed in the organization, yes.

The Chairman: In the operation itself or by way of investment?

Mr. Bergen: In the operation itself. It becomes a part of the total operation.

Senator Isnor: Mr. Melvin, you represent co-operatives across the country?

Mr. Melvin: Yes.

Senator Isnor: From Nova Scotia to British Columbia?

Mr. Melvin: Yes.

Senator Isnor: And you are in competition with other retail stores?

Mr. Melvin: Yes, we operate in the same communities and the same environments.

Senator Isnor: The only difference is that you are free of taxation for the first three years, is that right?

Mr. Melvin: At present there is an exemption for new co-operatives for the first three years of operation.

Senator Isnor: In other words, Mr. A who is representing a co-op and doing a business side by side with Mr. B, who runs a private enterprise, is free of taxation for the first three years?

Mr. Melvin: That is correct.

The Chairman: Under the present law. The White Paper proposes to do away with that.

Senator Isnor: I am getting the background. You have the privilege of doing business and maintaining stores which carry the same class of goods as competitors. And you have the benefit of free taxation for three years.

Mr. Melvin: This is the provision, sir. It has been the experience of co-operatives up to the present time that new organizations in the community, which are usually small at the beginning, do not enjoy an earning of any significance until they become established. However, what you state is certainly the fact in law.

Senator Isnor: That applies equally to the other type of store I mentioned. They have to become established, whereas you enjoy something for a period of three years that the other store does not enjoy. In other words, you may maintain your earnings and possibly put in a new store front, etc.

Mr. Melvin: This is correct.

Senator Everett: Mr. Melvin, you discuss in your paper the reinvestment of patronage dividends. Could you tell me how that takes place.

Mr. Melvin: Might I ask Mr. Dierker if he would deal with that.

Mr. J. J. Dierker, Solicitor, Co-operative Union of Canada: At the end of any fiscal period or term, your co-operative—or any other organization—if it has priced its merchandise accordingly, will end up with a surplus. This surplus is then allocated to the members who have produced that surplus in accordance with the business they have done. This is then credited to the members. Sometimes it is paid out in cash. The Income Tax Act at the present time allows it to be allocated in the form of shares or member loans. These can be for a term and are normally redeemed by the members. In addition, the provincial statutes require the co-operatives to redeem periodically the shares of members.

Senator Everett: This becomes part of your invested capital.

Mr. Dierker: This will be the invested capital.

Senator Everett: When you begin a co-operative there is a certain amount of investment which is an addition to the invested capital.

Mr. Dierker: It would be an annual addition to investment capital. The amount is normally very nominal.

Senator Phillips (Rigaud): When is the participant taxed, at the time of the allotment of shares or the crediting of the loan.

Mr. Dierker: He is taxed at the time of the allotment.

Senator Everett: In a producer co-op not a consumer co-op?

Mr. Dierker: That is right.

Senator Everett: Who decides whether the patronage dividends will be retained by the co-op as an addition to their capital?

Mr. Dierker: Normally it is provided in the bylaws of the association.

Senator Everett: So that an individual producer or consumer dealing with a co-op cannot make his own decision on that?

Mr. Dierker: He makes his decision as a member of that co-operative.

Senator Everett: He cannot make a decision from time to time?

Mr. Dierker: Not on an annual basis. I am sorry, he can make his decision from time to time on an annual basis by applying to withdraw from the co-operative. Then he has a right to have his equity or investment returned to him.

Senator Everett: He cannot continue to deal with the co-operative?

The Chairman: He can deal as a non-member.

Senator Everett: I say as a member enjoying the patronage dividend.

Mr. Dierker: Not unless he pays to other members as well.

Senator Everett: You say that this decision is made in the bylaws of a co-operative?

Mr. Dierker: Yes.

Senator Everett: In effect the consumer or producer, who as a member of the co-operative, is required each year to leave his patronage dividend and increase the capital of the co-operative, and the only way to get it out is by discontinuing his membership in the co-operative.

Mr. Dierker: This is theoretically possible, but it does not normally come to pass for the simple reason that the co-operative normally redeems the shares on an annual basis. The experience in co-operatives is that at least 50 per cent, or normally more than 50 per cent of the net surplus of the co-operative on an annual basis, is actually paid out in cash.

Perhaps I should have some of the treasury people answer this question instead of me as a lawyer. What happens is that you have your annual allocation to the members. Take as an example a member who had $1,000 as a member investment prior to allocation. Then he gets a $100 allocation, and at that time he has $1,100 in share equities. The co-operative, during the course of the year, may redeem 10 per cent or 15 per cent by way of general repayment of those shares. The experience has shown that at least 50 per cent of the net surplus of co-operatives is paid out in cash to the members. Does that answer your question?

Senator Everett: Indeed. Contrasting that to a patronage dividend by a private company, is there not quite a bit of difference between the two patronage dividends? Is it not a fact that the patronage dividends paid by a private company to a producer must be paid in cash–

Mr. Dierker: No.

Senator Everett: –in that year?

Mr. Dierker: No, that is not correct.

Senator Everett: Perhaps you could make it clear?

Mr. Dierker: The provisions in section 75(1) do not admit that patronage allocations are the same as they are for co-operatives. There is no separate co-operative provision for patronage refunds. Section 75 applies to any organization making a patronage

refund. For clarification, I should ask you whether you are talking about volume rebates, which are made by corporations, or patronage refunds under section 75?

Senator Everett: I see.

Mr. Dierker: Because there is quite a difference.

Senator Everett: As I understand it now—and perhaps you can correct me—you are entitled to pay out in dividends, in one form or another, an amount in excess of 3 per cent of the capital employed. Is that right?

Mr. Dierker: Yes.

Mr. Bergen: We are taxed on the greater, the 3 per cent of capital employed by the non-member business, but we can pay out the entire net earnings. Of course we would have to hold back sufficient to pay the tax.

Senator Everett: On what basis are you taxed now?

Mr. Bergen: It depends on the particular co-operative. There are three methods. If there is under allocation of patronage refunds, and are forced to put too much into reserves, it is on the amount that goes into reserves. This may be due to the particular statute in the province. Or, if they are capital intensive, with very little interest, then they may be paying income tax on the capital employed formula, or if they have a high non-member business, then they may be paying tax on the non-member ratio. So each tax file has to be looked at individually.

Senator Everett: How would that compare to a private corporation which pays, say roughly, 50 per cent of its tax on its income?

Mr. Bergen: As a percentage it is very low, on the net income. If this is the area of your question.

Senator Everett: Yes, indeed.

Mr. Bergen: It is very low in comparison.

The Chairman: It is low because the 3 per cent produces a low figure?

Mr. Bergen: The 3 per cent produces a low figure and from that 3 per cent we are allowed to deduct all interest except that paid to banks, credit unions, etc. in other words, normally the short-term borrowing. But it produces a relatively low figure.

The Chairman: But each individual who is a member, whoever pays the tax—does the individual have to pay it on his marginal rate, or does the co-op pay it for him?

Mr. Bergen: The co-operative, as we have illustrated, would pay the tax on the amount applicable, and the individual, if he is a producer, would take the dividend either as income or as a reduction in expense—the two would work out the same—and pay the tax on his individual basis.

Senator Everett: Effectively, does the White Paper do really nothing more than increase that retention rate from 3 to the farm credit corporation rate?

Mr. Bergen: It also changes the concept of the "capital employed", and here again we have not been able to get a definition of the capital employed as it would be under the new basis. We have, for the present one, because it was a part of the statute developed during the war and it has been used for the past thirty years.

Senator Everett: And what roughly is "capital employed" now?

Mr. Bergen: It is the total assets, less certain liabilities and reserves. I could go into detail, but this would take a fair amount of time.

Senator Everett: No. You are essentially concerned with the White Paper and the reserves?

Mr. Bergen: No, this is only a part of our concern. Our concern is the total concept that the capital employed would be changed and that the interest that is paid on the equity would be allowed as a deduction, but this is entirely different from the present capital employed formula and it would destroy the concept of being able to pay out patronage refunds. Instead, then we would be paying out a return on a member's equity and the earnings would be going out in that form basically each year.

Senator Everett: That is, that you would have the right to pay a return on the member's equity. If you chose not to, is it not correct to say that an amount up to 8½ per cent of the capital employed, as defined by the White Paper, would be income of the co-operative?

Mr. Bergen: And subject to tax.

Senator Everett: And subject to tax, but it could then be distributed with creditable tax?

Mr. Bergen: Here again we have not been given an assurance that this would be creditable tax.

Senator Everett: I am just going by the paper here.

Mr. Dierker: I would like to come back to a question you asked some time ago, which I never really answered. Your question was, could the co-operative pay this out as a return on member investment. It was one of the questions you asked that was never answered. You must appreciate that there are limitations as to how much can be paid out on member investment, generally by provincial statutes, to normally something in the area of 5 per cent, then it goes up to as high at 7 per cent in Ontario. As you can appreciate, this is below the 8½ per cent.

To carry that answer into the question you have just asked as to the passing on of creditable tax, if you get into the area of creditable tax in co-operatives, as you will appreciate from your work on the White Paper, this is a program which has been developed for corporations and as a way of passing on creditable tax along with share dividends or a return to the shareholders on the investment that they have.

Now, where you have limitations existing in statutes, you can readily find positions where a co-operative is prevented, even if it so elected, from paying on its member equity sufficient to pass on its creditable tax. This means that there is only one other distribution route to look at, and that it is in the form of patronage refunds, and it is very difficult, if not impossible, to follow through a program of passing on creditable tax, along with patronage refunds, because you are going to have, under this program, both qualified and non-qualified patronage refunds—those which have been qualified by either paying the 8½ per cent or paying the tax equivalent will be deductible, whereas those which do not so qualify not being deductible. Am I making myself somewhat clear?

Senator Everett: I think so. Coming back to the patronage dividends, can you tell me what happens when a private producer company pays a patronage dividend?

Mr. Dierker: The only experience I have is—that my father received some, and I honestly do not know whether it was in the form of cash or credit to be used in the purchase of merchandise from the grain company. I am sorry, I just don't know.

Senator Everett: Whether it was cash or credit, it was available to him, there was no decision made by the private company that he loan that back to the company?

Mr. Dierker: I am sorry, I just do not have enough information on that. If you want us to acquire it, we probably can, but I am sure you have those facilities.

The Chairman: Senator Everett, you asked the question concerning the White Paper proposal to change the capital employed.

Senator Everett: I asked what the definition of capital employed was, yes.

The Chairman: I wonder if we could get some amplification of that. I did not get enough from the answer to be able to understand what it was.

Senator Phillips (Rigaud): I was going to put a question that might help us, Mr. Chairman. I was wondering whether we could take a typical co-operative and take a given year, say, 1968 or 1969. Perhaps they could let us have a statement which we could look at first and then we could get a tax resultant on that particular year. Then, based on the White Paper, could you prepare for us a pro forma of what the tax position would be? And then we would be able to make a comparison in relationship to a particular company. We realize that with statutory provisions in different provinces and variations in types of co-operatives it is impossible to get a pilot plant figure that would be applicable to the whole, but to a good many of us this is a sphere of taxation with which we are not too familiar and it would be very helpful to us.

The Chairman: Right on this point, I have been reading as I have before the provisions in the White Paper in relation to co-operatives, and I am trying to find out where they talk about capital employed.

Mr. Bergen: They talk about members' investment as compared to the present concept or the definition of capital employed. I will try to amplify briefly. Today when we talk of capital employed under Section 75, et cetera, in the tax act, we take the total assets of a co-operative and deduct therefrom certain long-term and current liabilities. Now, what you are left with is more or less the equity section

of the statement, and when you have that residual amount you multiply that by 3 per cent. Just to illustrate, let us say you have total assets of $100,000 and you have liabilities, current and long-term, of some $45,000. That would leave you with basic capital employed of $55,000. You multiply the $55,000 by 3 per cent and from that resulting figure you deduct the interest on your long-term borrowings, and the net result is the amount that is used for taxation purposes, and the tax rate would be applied. Under the White Paper proposal as we understand it we would take only the equity section and the only deduction that would be allowed from that would be the interest paid out to the members on their shares, which is entirely different, as you can see. We are now talking about the member's investment only and we are talking about the interest paid to the member, whereas under the present method we talk about the assets less certain liabilities and the interest paid to other than members. That is, interest paid on long-term borrowings.

The Chairman: Do you think the purpose of this is to force out greater payments?

Mr. Bergen: We can only speculate that this appears to be the purpose, since it was referred to in the Carter Report and others have suggested that we have a certain advantage in being able to retain the patronage refunds and have them reinvested in shares. But all of our studies have indicated that the reverse has applied because of the high percentage that we pay out year by year and the number of members that retire or leave or move away from the co-operative and the disinvestment that takes place at that time. We are losing more than 50 per cent of the current surplus each year, and because there is no ready access to the market to sell additional shares, it means that our gain in assets—and we have done several studies in this regard—has been slower than the industry on the average in Canada.

The Chairman: Senator Phillips (Rigaud) was suggesting that we might get a statement and have it broken down on a basis on which we could understand it. Remember, you are specialists in this field. We would like to have it done in the "A, B, C" fashion.

Mr. Bergen: Mr. Chairman, we would be pleased to do this, as indicated earlier. But you must realize that we have had to make certain assumptions. We have visited the department twice to try to get clarification of members' investment. We have not been able to receive it. So in our statement we would outline the assumptions that we are making.

The Chairman: Can we get that reasonably soon?

Mr. Bergen: Yes.

Senator Carter: Mr. Chairman, supposing a group of fishermen were to use a co-operative to market their product, would a statement from them be the same type of statement you are producing for Senator Phillips (Rigaud) on a retail co-operative?

Mr. Bergen: The statement would not make any difference as to whether it was marketing or retail. The principle of patronage repayment would be the same.

Mr. Dierker: Just to amplify that, Mr. Chairman, I should say that if the fishery co-operative that you refer to, senator, was what is termed "an agency co-operative", the co-operative itself would have no income and it would all be passed back to the members.

Senator Carter: Yes.

Mr. Dierker: As you know, this applies to corporations as well, and we have a fair number of tax cases on that. Where basically someone contracts to pay the earnings to someone else, it is not your income. And if the contract provides for the payment of total earnings, then there just is no surplus and there is no tax base there.

The Chairman: There would be just a management fee about equal to the cost of doing the job.

Mr. Dierker: This is one thing you should appreciate about co-operatives; most of the provincial statutes do in fact provide that apart from minimal returns on member equity there is a statutory provision requiring this return back to members. You have the amplification over and above the contract level.

Senator Phillips: Basically your exemption is based upon the fact that the co-operative is really the agent for the participants, and when you get into the area of retention on other types of earnings and the like, then you are subjected to some form of corporate taxation.

Senator Everett: Dealing with that as a generality, the figure now is 3 per cent?

Mr. Dierker: For legislative tax purposes the figure is 3 per cent, which co-operatives have been able to comply with because the statutory provisions allow setting aside that portion. Are you following me? When you get to a rate over and above the statutory provisions, you are getting to a real hiatus because you are not able to legally comply.

Senator Everett: I think we understand that, but what the Government is in effect saying is, though—since you can decide for the individual consumer or producer that he will leave his patronage dividends on deposit as an addition to capital in the co-operative—that a fair rate of return should first be paid on that capital before patronage dividends are distributed.

Mr. Dierker: I hope this does not sound facetious, because I certainly don't intend it that way, but I suppose that co-operatives could quite as readily ask whether the Government is in a better position than the members of the co-operative when they set up the co-operative to decide how the surplus is to be distributed. The Government in these White Paper proposals has directed this type of return to be deemed to have been earned on member investment.

Senator Everett: You have been living with that situation for some time.

Mr. Dierker: The co-operatives have been living with a capital employed situation.

Senator Everett: The increase from 3 per cent to 8 per cent under the present borrowings cost the Government 8½ per cent.

Mr. Dierker: There is one thing you want to appreciate, and that is that the Government is not going to gain by this proposal. It is not a matter of raising governmental revenue, because the other provision in the White Paper proposals allows a provision that does not exist. One thing you want to appreciate is that in so far as it is a corporate body, the co-operative is being better treated in the White Paper proposals than it is the present situation.

Senator Everett: But only for as long as it pays out the 8½ per cent. So that in fact the Government is saying if you pay out to the holders of capital in the co-operative, then the co-operative will not be taxed, but if you choose to hold that 8½ per cent on capital, then you will be taxed. Is that not correct?

Mr. Dierker: That is the interpretation.

Senator Everett: So that in fact the Government is giving an incentive to you to pay out your earnings to those who have invested capital in the co-operative. Is that not so?

Mr. Dierker: Well, far be it for me to suggest what was in the draftsman's mind.

Senator Everett: You have been suggesting earlier what was in the draftsman's mind and I thought that perhaps you might like to continue.

The Chairman: Mr. Legere, we have been skipping over you here. Is there anything you would like to add. I take it that basically your position with regard to the White Paper is the same as that of the other co-operatives.

Mr. Legere: Perhaps I should say that the Conseil Canadienne, which is the French-speaking organization, is basically the same as the Co-operative Union of Canada, and we fully agree with what they have said here. Concerning employed capital, last night I tried to make a very simple sketch of what employed capital was, and for the purposes of the sketch I have taken for granted that a co-operative would have $100,000 in capital made up as follows; members' loans—$10,000; ordinary share capital—$70,000; preferred share capital, which is rather an exception,—$10,000; reserves—$5,000; and undivided earnings—$5,000; and this makes a total of $100,000.

Now, at the end of the year this co-operative had net earnings of $8,500. According to the proposals made in the White Paper, if we were to pay, let us say, 15 per cent interest on the members' loans, we would get $1,500, and 10 per cent interest on the share capital would amount to $7,000, which is a total of $8,500. In that case we would not have to pay a red cent in income tax. However, we feel that this is contrary to the philosophy and the total way of life of a co-operative.

A co-operative basically distributes its income in relation to the shares held by the members. We pay a normal and reasonable rate of interest on the members' capital, and on members' loans, and then basically we distribute our profit or surplus according to the business done by each member. In the case of a producers' co-operative, for example, the members who receive, let us say, $100 income in rebates would add this to his personal income or

consider it as a decrease of his cost of operation, which comes to the same thing. But we feel that in a consumers' co-operative, a member receiving $100 does so simply because of the fact that at the end of the year the co-operative has found that it has overcharged him by that $100.

I feel the situation is exactly the same as if you were to go to a store where there is a sale and buy a hat which was originally $10, but which has been marked down to $9. By buying the hat at that particular time, you have a saving of $1. But you do not have to report that $1 saving as income. In a co-operative, you could buy exactly the same hat at $10, but then at the end of the year, the co-operative finds out that you have been overcharged by $1, and they send back that $1 to you. Do you think you should report that as income? After all, you have simply saved $1 in buying the hat, so should you let Mr. Benson know about it?

Senator Everett: Is that not the position under the present Income Tax Act?

Mr. Legere: Yes.

Senator Everett: And is not that the position under the White Paper, that patronage dividends paid to the consumer—all they say is that you should pay a return on capital first.

Mr. Legere: At a stipulated rate which is well above what we have been paying and well above what the provincial legislation tells us we should pay. It limits the interest on the capital. For example, when you invest in a co-operative or when a farmer invests in a co-operative, he does not invest to make an income on his investment. He invests to receive a service from his co-operative. When a fisherman in Newfoundland invests in a co-operative, he usually does not invest money by the $10,000, but sometimes by the $1 or by the $10. And he invests because he feels that by investing the $10, he is going to get half a cent or one cent or two cents more for his fish. This is the basic difference between a co-operative and a capitalistic organization. We feel that the Government does not have the right to tell us which way of life we should choose, and if we choose to operate on a co-operative basis, we feel that that is a basic right which each Canadian has.

The Chairman: So what you are telling us is that the provisions of the present Income Tax Act are wrong and should be eliminated?

Mr. Legere: No. In our proposition we say we want to be considered as ordinary Canadian citizens, and we are making a proposition to the Canadian Government. We want to be taxed according to the rate of the personal income tax in each province, let us say 10 or 12 per cent. We don't want to evade taxation; we want to be taxed according to the standard applied to the ordinary Canadian citizen.

Senator Everett: By the present rule?

M. A. Morin, Directeur du Service de Recherches—Federation des Caisses Populaires:

[*Translation*]

I am greatly surprised to see your interest in this question, this idea of capital employed. This idea of capital employed was parachuted into the co-operative system in 1947. It has never been accepted by the co-operatives. It has never been recommended by any commission that has studied the co-operative system. It is a political compromise that goes back a long time. Aside from that, it is not the remark of someone in the co-operative movement; Professor Mackay is not someone hired by the co-operatives; he is not someone to side with the co-operatives, and yet he stated in 1962, and repeated it to the Canadian Tax Foundation in 1969, that this system is illogical and that if they wanted the co-operatives to be taxed more, they should look for something more logical.

You are rebuilding the tax system. You have a logical approach to taxation of the small corporation, the partnership, the closely-held corporation and the widely-held corporation; you have a whole system that is logical. So the first part of Chapter 4 of the White Paper is very logical; again we subscribe to it 100%.

However, you come to the section on co-operatives, and it seems to have lost all logic. It's as though, after having drawn this very logical background of taxation of businesses in general, you said, "Hey! , we've forgotten the co-operatives somewhere; put down something about the co-operatives." And the nice fellow who had to write something about the co-operatives, not knowing where to start with the problem, went digging into the current taxation and came up with this idea of capital employed which now exists, but was never, I say again, recommended by the co-operatives, and never recommended by any commission studying co-operatives. He came up with that and said: "Why not bring that up to date? ".

Three per cent interest was perhaps not much in 1947, but it certainly is in 1970. And then they come with an idea of a fluctuating interest rate for the Farm Improvement Act. Three per cent of the capital employed wasn't bad, it wasn't logical, but it wasn't bad, because the figure wasn't large. But, when you come with 8½, that's when the law is the decision-maker instead of the co-operatives. The co-operatives are no longer entitled to distribute their overcollections as they wish. They are compelled to follow the law. There's one question I'd like to ask: where else do you find taxation based on a percentage, on the yield of capital employed? Why not on the labour employed? Why not on the raw material employed? Why do you talk about capital employed? You are going to tell me that it's to get the co-operatives to distribute their money. I think taxation should have no interest there. In a tax system, the interest should be to make certain that the co-operatives carry their share of the country's expenses. But if the members of the co-operative movement, at an annual general meeting, wish to make a decision to leave the co-operative's overcollections in the co-operatives's reserve, they should have the right to do so. It's a majority of the members that makes such a decision.

Senator Desruisseaux: With your permission, Mr. Chairman, I'll speak in French this time because I find myself with persons whom I know well. I recognize several of them here, and it's a pleasure to see them again. They are ardent workers. As you can see, they work very hard for their interests and those of their members. Yet, with all that, you know, I was watching Mr. Morin with his comments a little while ago, and I think just the same that they are not the only ones to have positions they are not fond of. We're all in this boat, whoever we may be, in a country, ours, as in other countries. In that connection I'd like to ask Mr. Légère this question: have comparisons been made of taxation with the other countries in the world, and mainly the United States and Great Britain, where co-operatives have been accepted as such? Have any studies been made on that relationship, which reflects the taxation system in those countries?

Mr. Légère: I think that one of our official representatives, Father Bouvier, probably has an answer to that question.

Father Bouvier: Well, Mr. Chairman, I don't think I can answer a question like that right off, but I must say that if you examine the legislation on the taxation of co-operatives in Japan, France, England and Germany, there isn't any at all; there's taxation on operations with non-members, but as far as the taxation of co-operatives is concerned, in a very large number of countries they don't have it. I have to give you a fairly general answer here, because it is rather difficult to have recent information, but in the years around 1968 we made inquiries, but I must say that in the legislation that I've gone through, and that dates, unfortunately, to 1966, I must say that co-operatives are generally exempted from taxation, except for operations with non-members and the income from investments in operations that compete with free enterprise.

Senator Desruisseaux: Father Bouvier, is that the case in the United States?

Father Bouvier: In the United States, I can't tell you exactly, because there's government legislation, of course. But I must say that there's no categorical legislation on co-operatives like what we are working out.

Senator Desruisseaux: Not in Great Britain either?

Father Bouvier: Not in Great Britain either.

Senator Desruisseaux: Can one of the caisse populaires do the necessary research to get this information eventually?

Father Bouvier: As a matter of fact that research has already begun. The correspondence is going on but, as you know, it's very hard to get an immediate reply. We have written; our taxation committee began writing last November. I think we've received a few replies, but I must say that the comparative study of legislation on co-operatives is not up-to-date for 1969.

Senator Desruisseaux: It would perhaps be useful, in view of Mr. Morin's remarks, to have that kind of study in front of us.

Father Bouvier: I agree, Senator.

[*Text*]

Senator Phillips (Rigaud): Mr. Chairman, before we leave I wanted to explain to Senator Everett, and I think others, the forceful point made by Mr. Morin that in principle they were aginst any taxation based upon interest on capital employed, that the logic should have evolved resistence when the amendment then came through, that the co-operatives did not

accept it as a matter of principle but the amount was small and they paid no attention to it. However, now that the rate is being increased, the fundamental principle to which they adhered, that of non-taxation in respect of capital employed, now becomes a serious one for them. Possibly they should have objected previously, but they are now objecting with considerable force. He admits the lack of logic, in the sense that there was a rate of taxation to which the co-operatives allowed themselves to be subjected.

Whether or not that satisfies you, Senator Everett, at least it explains it. He claims a lack of action on the part of co-operatives and, in any event, points out that the co-operatives never agreed to the conception of taxation based upon capital employed and always objected to it fundamentally, as a matter of principle; and their violent or strong reaction to it now is based upon the concept to which Mr. Legere also refers, that it is a violation of the fundamental concept of the basis upon which co-operatives work.

The Chairman: I understand, Mr. Melvin, that some years ago there was a royal commission set up, and among the things they studied was the position of mutual insurance companies and co-operatives, was it not?

Mr. Melvin: Yes.

The Chairman: They made a report, and it was following that that you had this introduction into law of these provisions in relation to taxing co-operatives, is that right?

Mr. Melvin: Yes, Mr. Chairman. As I understand it, the 3 per cent provision was not a recommendation of this commission, but it came forward in the law as it eventually took shape on the statute books. This was the McDougall Commission in 1945-47.

The Chairman: That is right. Now it is eating time, it being 1 o'clock . . .

Senator Haig: It was eating time half an hour ago.

The Chairman: You are on Atlantic time, are you?

The proposal is that we resume at 2.30 p.m. today, because Senator Molson has the committee on Rules meeting at 2 o'clock.

You gentlemen will be back with us on the Caisses Populaires brief, and if you feel that we have not finished this discussion you can be here at 2.30 and we can carry it on.

Mr. Melvin: We will be very happy to be back, Mr. Chairman. Before you begin this afternoon, might we have a word with you as to whether we might come back for a few minutes?

The Chairman: Yes. We are going to resume at 2.30 p.m., and if there are still things to be said, we will be ready for you.

Mr. Melvin: Thank you very much, sir.

The committee adjourned until 2.30 p.m.

Upon resuming at 2.40 p.m.

The Chairman: Gentlemen, I call the meeting to order. I have been advised by the Co-operative Union of Canada that unless we have more questions to ask them, they have nothing further to add. That being the case we shall proceed to the submission of the National Association of Canadian Credit Unions, and I will ask Mr. May, the treasurer, to present his delegation.

Mr. G. May, Treasurer, National Association of Canadian Credit Unions: Thank you, Mr. Chairman. On my immediate right is Mr. Robert Ingram, the General Manager of the National Association of Canadian Credit Unions. Next to Mr. Ingram is Mr. L. Tendler, who is a director of the Canadian Co-operative Credit Society, from Regina, and then, Mr. Joseph Dierker, a solicitor from Saskatoon and our legal representative. Mr. Graham will be here before very long.

Mr. Chairman, this presentation by the National Association of Canadian Credit Unions, NACCU, is made on behalf of the member organizations and the Canadian Co-operative Credit Society, which is the federal central credit union for our provincial central credit unions.

The purpose and scope of our submission is generally to comment constructively on some of the White Paper proposals, namely, sections 4.68 to 4.73, with a supplementary comment on section 5.9.

We would like to point out that credit unions are unique collective organizations and that our reserves should be related to the nature of the operations and

risks which are, in fact, not similar to those of banking institutions.

We also point out, Mr. Chairman, in our brief that because of the nature of credit unions and their financial structure, the majority of them are still small units that operate on a non-profit basis, and all are under provincial legislation, control, and supervision. The share capital of credit unions, we suggest, is akin to bank savings accounts. Shares are not transferable and are not subject to capital gains, and the voting on these shares is not related to the number or the value of shares.

The Chairman: Did you say they were non-transferable?

Mr. May: Yes. We also point out in our brief, Mr. Chairman, some of the basic differences between credit unions and other co-operatives. Credit unions deal only with their members. We are restricted in the amount of dividend we can pay on our shares, and generally it is 6 per cent. We are restricted as to the interest we may levy on our consumer and other loans. We point out the restrictions on allocations of reserves in the event of liquidation, and that the returns are taxable in the hands of our members. Patronage refunds are less important in credit unions, and credit unions pay full commercial rates of interest.

The Chairman: Would you stop there for a moment, and allow me to ask you whether you deal in more than money.

Mr. May: Mr. Ingram will be able to answer that question.

Mr. R. Ingram, General Manager, National Association of Canadian Credit Unions: I would suggest, Mr. Chairman, that our only commodity is money.

The Chairman: You do not acquire and operate businesses?

Mr. Ingram: Not as such, no. We are only service organizations to meet the needs of the members. I do not know whether they could be considered as businesses.

The Chairman: You may finance business; is that right?

Mr. Ingram: It is possible.

The Chairman: Would that include the management of it?

Mr. Ingram: In some cases, yes.

Senator Beaubien: If you have a loan that is not going well, you put in management?

The Chairman: No, I meant more than that. I was asking whether they would take on the management of a business, and invest money in a business.

Mr. Ingram: No.

Senator Burchill: Are the regulations you have outlined here provincial or federal? You say you are restricted to a dividend of 6 per cent on shares. Is that a provincial or a federal restriction?

Mr. May: It is provincial. We are referring here specifically to the individual credit unions, which are provincial bodies.

Senator Aseltine: They are all provincial institutions?

Mr. May: Yes.

Senator Aseltine: And they are all financial institutions?

Mr. May: That is correct.

Then, Mr. Chairman, we refer briefly to the area of capital employed and its effects. In our brief we define "capital employed" as share capital reserves and surplus, and again we emphasize the difference between our shares and what might be termed the ordinary corporate shares. We point out that interest and dividends should be treated as operating expenses in the credit union because of the relationship between our shares and bank deposits. We point out that share capital is not locked in, and that the capital employed is minimal in credit unions. We point out that credit unions pay commercial rates, and that patronage refunds as well should be deductible.

Finally, Mr. Chairman, we suggest that there are some real differences between credit unions and banking institutions, and that in the area particularly of reserves there are reasons for suggesting that we cannot realistically be compared to banking institutions.

The area of retrospective taxation is commented upon in our presentation. We have as well a section in our brief dealing with the co-operative societies,

which are the provincial central credit unions, and we have present a representative of them to provide any additional information that the members of the committee may require.

One supplemental area, perhaps, aside from the main matter of credit unions and the White Paper, that we comment on is that of entertainment and related expenses. This is section 5.9.

In the summary and conclusion we suggest that dividends on capital and loan interest refunds should be deductible; that bad debt and market liquidity reserves should be those required by provincial statutes; that accumulated reserves should not be considered as opening reserves; that assessments and losses re stabilization funds should be deductible; that participation in meetings should not be discouraged; and that credit unions as unique personal organizations are distinguishable from banking institutions and other co-operatives.

We feel that growth is not a proper criterion for taxation, and we point out our need for higher reserves, and the fact that capital gains are remote in our institutions. The returns to our members are taxable in their hands. We suggest that our tax exemption should continue, and we indicate that the single taxation concept is fair, and should be supported.

Mr. Chairman, before we proceed to your questions may I introduce another member of our group who has just come in. He is Mr. Frederick Graham, a chartered accountant from Vancouver, British Columbia, who is our financial adviser.

Mr. Chairman, that is a resumé of our presentation.

The Chairman: Have you set out what your position would be if you took your actual operating statement for 1969 and applied the new taxation provisions to it?

Mr. May: That is, if we applied the White Paper Proposals to it?

The Chairman: Yes.

Mr. May: Mr. Graham, would you indicate our position on that?

Mr. F. Graham, Chartered Accountant, (Vancouver, B.C.): Speaking for the province from which I come, British Columbia, we estimate that the amount of taxation would be somewhere in the neighbourhood of $300,000-odd each year. That would be a growing thing. If they did introduce a retrospective aspect in connection with reserves presently accumulated, this could go to a much higher figure.

The Chairman: Have you done this graphically so that we can have a picture in front of us?

Mr. Graham: I imagine that we could draft something up very quickly in relation to the total assets in each of the provinces.

The Chairman: Yes, take the year 1969, and show us what the impact would be. Of course, in 1969 you were not subject to federal taxation.

Mr. Graham: That is right. You appreciate, when you say this, that one would have to make a consolidation of all the statements? You follow that there is not just one credit union: there are hundreds of credit unions?

The Chairman: Yes.

Mr. Graham: One would have to make a consolidation of all of those in order to give you the picture you are speaking of.

The Chairman: That is right, but each one would be separately taxed under the proposal.

Mr. Graham: That is right.

The Chairman: But I think a consolidation would do for our purposes.

Senator Phillips (Rigaud): Yes, Mr. Chairman, I would think so. I would like to put a question as to the background of the formation of the credit unions. I think all members of the committee are appreciative of the activities of the co-operatives, but I for one am wondering where the general banking system has fallen down, thus causing the creation of the credit unions. What is the specific background that prompted the formation of this particular type of organization. I think that that will have a bearing on our consideration of the special treatment to which you feel you are entitled.

Mr. Ingram: Mr. Chairman and gentlemen, to answer that very brutally and without getting into some kind of a philosophical discussion, I will say that historically the credit unions began and developed because of a necessity to meet the needs of

what we have always called the little man, or the person who is not able to obtain credit from any other source than a usurious source, and this included the chartered banks at that time. It is only in very recent years that the chartered banks have got into the consumer credit field at all to any large degree.

It was prior to this time that the credit unions almost naturally developed to fill a very real need for their instalment and mortgage needs.

Senator Phillips (Rigaud): Are your lending facilities confined to your own resources, or do you in turn call on the commercial banking system for further support?

Mr. Ingram: No, we are not entirely restricted to the accumulation of savings of our own members. We are able to use the resources of commercial banks or other sources to meet our credit needs within the framework of the legislation in each particular province.

Senator Phillips (Rigaud): So that your working, available funds include not only the resources of your members by way of subscription or reserve, but also your own borrowing power from the commercial or other banks?

Mr. Ingram: Right.

Senator Phillips (Rigaud): Could you give me some idea of the proportion of moneys used by credit unions at large that belongs to the participants, as distinguished from the moneys you get from normal banking sources?

Mr. Ingram: I would hazard a guess that probably around 95 per cent would be our own funds. This figure will vary from time to time and sometimes on a seasonal basis.

Senator Phillips (Rigaud): That is a very important answer, because it would justify special treatment.

Senator Burchill: Mr. Chairman, I have a very warm spot in my heart for credit unions. A credit union where I live was built during the depression in the 1930s and has just built our community. It is our banking centre for thousands of wage earners. I cannot say too much for them.

The Chairman: Do you aim to make a profit on your operations?

Mr. Ingram: No sir.

The Chairman: What happens if, inadvertently, you do? How do you deal with it?

Mr. Ingram: We have always maintained and done this, that the earnings that accumulate at the end of any particular fiscal year are returned to the members by way either of dividend on their shares or interest rate on their deposits depending on the differential of the capital, or an interest rebate to the borrowing members. This, of course, is after the statutory reserves are allocated as required by each individual province. Funds which we refer to as allocated surplus or undivided earnings are negligible.

The Chairman: If you found you had something which might otherwise be called profit, you have a variety of methods of disposing of it, by reducing the interest rate on loans, paying a dividend to your members, or maybe a little more interest on their deposits.

Mr. Ingram: That is right.

The Chairman: And you end in a flat position. What element is it then of the co-operative treatment under the White Paper which would apply to you? How would the formula work out?

Mr. Graham: Generally the White Paper indicates that the interest on shares will be deductible. It is our understanding that this will be so. We call this dividends, but we should recognize that shares that people put in, in effect, are really savings accounts. They are analogous to the savings that people put into the banks.

I doubt very much if people putting money into savings think of them as share capital within the legal sense. As far as they are concerned, they put it in today and take it out tomorrow. There is a constant revolving of these funds.

The Chairman: The credit union gets its money mainly from deposits.

Mr. Graham: That is right.

Senator Molson: Do they pay interest on these deposits, or are those the dividends you speak of?

Mr. Graham: There are two classes. There are deposits in the credit union just as in banks. We also have what we call shares, which are analogous to

savings accounts in chartered banks. Those are not available for chequing purposes.

The Chairman: They are time loans.

Mr. Graham: No, not necessarily. We have time deposits much the same as the banks. We have also chequing deposits. These are both liability accounts. We pay interest on deposits. It is an expense of the credit union and no question comes in here.

The Chairman: You pay for the use of the money.

Mr. Graham: That is right, precisely.

The Chairman: And the man who gets the payment puts it in his income tax return?

Mr. Graham: That is right.

The Chairman: What element do you have that is regarded as having some income content?

Mr. Graham: The income content that we appear to be left with now on our interpretation of dividends, as we describe them, or interest on shares which will be allowed, will only be the matter of reserves.

It is rather complex, because we come up against the problem that we have provincial regulations and law which indicates, of course, how much we must put aside. This law has operated for some 20 or 30 years, as the case might be.

Before we make any distributions to shares, we must put a proportion aside into reserves. Now the question arises as to whether the amounts of reserves are properly reserves or some of it could be deemed under this paper to be income of the organization and tax reportable.

Our contention is that it is not income. These are reserves that are required.

The Chairman: You do not isolate them and bury the money. You must put it in some form.

Mr. Graham: It is re-invested in the organization in loans or our cash reserve, but it is employed for the use of the credit union.

Senator Molson: It is a question of whether it is tax paid or tax free reserves. They are tax free now and it is proposed that they be converted to tax paid reserves.

Mr. Graham: The White Paper says they are going to be comparable to those of banks. We do not know what comparable means. We will get what we hope are going to be adequate reserves.

Senator Molson: Yes, they would be taxed first.

Senator Everett: If the reserves are those limited by the provincial government they would be reserves before tax.

Mr. Graham: That is right.

Senator Everett: And this is what you would like.

Mr. Graham: This is what we want, precisely. In fact, I suggest to you that if we get the reserves which we consider adequate, no more money will be added to reserves.

We have credit unions in my province that have reached the statutory minimum requirement whereby they are not required to put more money in. The remainder of the earnings is distributed to members now.

Senator Everett: Is that 5 per cent?

Mr. Graham: It is 5 per cent in our province. You may elect to distribute the other. Generally the practice has been that all we want is sufficient to protect the assets of the credit union. That the funds of people who have money on deposit and in shares are protected.

The Chairman: If you do not distribute after you have met the full requirements for provincial reserves, you get an element of profit there.

Mr. Graham: Well, we would distribute it. Let me put it this way . . .

The Chairman: I am not objecting. You would have to distribute it.

Mr. Graham: I think what one should recognize is that we have two groups of members; one borrowing and one, in effect, saving. In effect, there is a conflict of interest here; one wants to get the lowest borrowing rate and the other wants to get the maximum. I think it should be recognized that in most provinces members may not participate in reserves. When we say there is no capital gain, if a credit union in Quebec, Manitoba, Saskatchewan or British Columbia is wound up there is no distribu-

tion of the reserves or remaining surplus to the credit union members.

Senator Molson: Where does it go?

Mr. Graham: In B.C. it goes to what we call our insurance fund, which again is an insurance fund for shares and deposits. In Quebec it is under the Lieutenant Governor in Council who decides where it will go. It will not go to the members. This is the element that I think we should recognize, which removes the profit making aspect from the credit unions, because we have nothing but the investment that will come out; that is all that can come out.

The Chairman: You have an extra there though, Mr. Graham, the amount of the reserves which has come out of your operations.

Mr. Graham: Who is the extra for?

The Chairman: I am wondering who owns it.

Mr. Graham: I am saying that it will never come to the member.

The Chairman: I say, who owns it?

Mr. Graham: On distribution it will stay there as long as the company or organization that operates it. If it is wound up it will go to some fund outside the credit union. It will go to increase funds in B.C. Much the same with C.D.I.C. We are not eligible for C.D.I.C.; we have created our own fund. Saskatchewan have a fund created, and other provinces have funds created.

Senator Everett: You have dealt with that in section 4.6.

The Chairman: You have no way of bringing it back?

Mr. Graham: No way. This is why you can never get a capital gain. You can never get more than $5, which is the amount you put in for your share.

Senator Everett: Mr. Graham, as I understand it, the provisions of the act, if applied to credit unions, would require you to pay 8½ per cent interest at the present time on your share capital.

Mr. Graham: We must avoid misunderstandings here. Only if we are going to declare a patronage dividend. This 8½ per cent rule applies only as to the deduction for patronage dividends. Before you may deduct a patronage dividend you first must have retained in your organization the equivalent of an 8½ per cent return. We say in our brief, of course, that this should not happen, because credit unions have gone into the market place and have paid the market price for money to attract money into shares. Why should the Government in the White Paper suggest in the way they do that we should have paid a bigger amount than banks? If I am a bank and trying to get your money and Mr. Dierker is a credit union trying to get your money, we are both offering the same money. Why should there be a rate of 8½ per cent imputed in respect of savings account when the market says it is only 4 or 4½ per cent.

Senator Everett: Your provincial law, I gather, confines you to a maximum of 6 per cent?

Mr. Graham: Yes, 6 per cent. Again, I suggest the principle of capital employed on this 8½ per cent is a different consideration.

Senator Everett: If credit unions were allowed the provincial reserves under their present operation, do they pay any patronage dividends now?

Mr. Graham: We started it pretty well. In most provinces it has become unimportant for two reasons. One is that the price of money has gone up. The second is that there is more or less a ceiling as far as the lending rate is concerned, so we have had the squeeze coming in all the way through. If later on interest rates come down, as we hope, and we have a bigger spread between what we are lending and what a person is getting for his savings, then there will be some room to allow patronage dividends. We do not want to say we are not interested in patronage dividends, because we may be interested. After all is said and done, after you have made proper payment to this member and that member for savings, it is proper that the other member who does the borrowing should be considered too. This is the philosophy.

Senator Everett: You are saying that you should be viewed in a special way because you are really just borrowing money and re-loaning it and not taking a profit.

Mr. Graham: The White Paper tries to impute a rate in connection with the proper price for share money. I suggest when we get our money in the market there is no reason to impute a rate. There is no soundness to it, no logic to it.

Senator Everett: The market takes care of it.

Mr. Graham: That is right. In addition to which, if you want one further argument in connection with capital employed, I suggest that credit unions, within the proper concept of the capital employed, have not got the capital employed. Really we have no legal amount of money; there is from the strictly legal point of view, but the accounts themselves may be withdrawn at will. There is a constant revolving fund, and it is not in a strict sense shares as one would imagine.

Senator Molson: I find that a slightly more difficult concept.

Senator Everett: Your shares are redeemable on demand.

Mr. Graham: Yes.

Senator Everett: And there is a high turnover?

Mr. Graham: Yes. We made a survey in 1957 in B.C. and found the total volume turned over once every two and a half years.

(Senator Lazarus Phillips, *Acting Chairman,* **in the Chair.)**

The Acting Chairman: Any further question?

Senator Beaubien: I would like to ask Mr. May one thing. What do you say about the voting rights? You said it did not depend on the amount of money put up. How do your members vote?

Mr. May: It is what we call an inherent co-operative principle; it is one member, one vote, irrespective of the number of shares a member has on hand with the credit union.

Senator Carter: Are your members all individuals, or do you have other co-operatives as members?

Mr. May: In some provinces there are co-operative associations that have memberships in credit unions, but it is a minimal amount. I do not know whether any of my colleagues might give a specific figure, but there is a very small number of members other than individuals.

The Acting Chairman: I should like to put this question. I was very interested in what Mr. Morin said this morning on the fundamental question that if we recognize co-operatives in the sense that they are really only agents for those interested in them—and this would apply to credit unions—there should be no taxation of any nature whatsoever against either the co-operatives or the credit unions. Mr. Morin claims that there is no logic at all in any taxation, even at the current, I think, 3 per cent level.

Senator Aseltine: The members are in business for themselves.

The Acting Chairman: Yes, and ultimately they will be taxed. If we are dealing with an attempt to re-vamp our entire taxation system, directing ourselves only to credit unions, do you think there is any merit to what Mr. Morin said when he spoke specifically of the co-operatives on that point?

Mr. Graham: I suggest that it is not beyond the realm of possibility that one might in a credit union—this was brought by the Porter Commission, and in the select committee of the Ontario Legislature you will find reference to this same matter—develop insurance facilities within the provinces to insure shares and deposits, thus taking the risk on to the insurance fund.

A simple device I would suggest to you is converting the shares into savings accounts which will make these things a non-taxable organization where no part of the profits accrues to the members.

The Acting Chairman: Developing the subject matter further, in this instance I would like to direct myself to Mr. Dierker who spoke very ably this morning as solicitor for the co-operatives. Some of us see it here that you are subject to provincial law, and you probably have here in the present federal law and in the proposed change in the law a type of taxation involving the computations of capital reserves, and all that sort of thing, which are inconsistent with statutory legislation to which you are presently subjected. I was wondering, Mr. Dierker, whether there is anything to the point that any federal system of taxation applicable to you, meaning to your constituent companies, should be related to and consistent with the provincial laws applicable in the various jurisdictions?

Mr. Dierker: Mr. Chairman, there is no question that that position should be recognized by this committee. I have attempted to develop that posi-

tion to some extent in the briefs of the co-operatives, in the CUC and CCU briefs. I have made some brief reference to it and to the serious problems in litigation which have occurred over it in the United States. I would hope that we could avoid that situation for co-operatives and credit unions in Canada.

There really is no question that they could not qualify in the way envisaged in the White Paper. This would involve a taxation position which in all likelihood would put them in a non-competitive position, and they would not be able to pass on this creditable tax.

The Acting Chairman: This is consistent with your legal obligations to the various provinces in which you operate.

Mr. Dierker: This is correct.

The Acting Chairman: These questions are being put to you by this committee, which is obliged not only to consider the merits of what you say but to express an opinion and to make suggestions and recommendations. Taking the view presented by the co-operative union this morning and what we are hearing now and what we are going to hear in due course from the La Fédération des Caisses Populaires Desjardins, I am wondering whether it would not be possible to simplify your conclusions in a consolidated recommendation as to what might be considered desirable even if it went to the point of you taking the position that you should not be taxed at all, or, if you were taxed, that you should be taxed on a basis consistent with your obligations under your respective provincial statutes.

At the moment I think you get a reaction of sympathy to your problem, but I am not too clear as to whether honourable senators will know how to grapple with it from the point of view of a real recommendation. I am trying to be a bit of a realist.

Mr. Dierker: Mr. Chairman, if I might comment on that. Dealing with the brief that was presented to you this morning to which I might address myself, there is a suggested solution presented in it. We dealt this morning primarily with the objection to the proposal outlined in the White Paper, and little if any time was spent on the actual constructive proposal made. This, I would recommend for your consideration.

The Acting Chairman: I read that, Mr. Dierker, but did I miss the fact that you dealt also with the inconsistency with respect to existing provincial legislation?

Mr. Dierker: The proposal we have recommended is consistent with provincial legislation. With respect to the credit unions, whose position is before this committee at the moment, they are asking that the committee recognize the provincial restrictions with respect to observing requirements, and that only after that should any consideration be given to any proposal of taxation. At that point the situation is such that for all practical purposes they should be classified as tax exempt.

The Acting Chairman: Are there any other questions, honourable senators?

Senator Carter: There was one point which Mr. Dierker made this morning from the standpoint of revenue. It was that the White Paper proposals did not give any increase in revenue. I am talking about co-operatives generally. I was wondering when he made that statement whether he was just applying it to co-operative organizations or was he taking into consideration that if all surpluses were distributed the Government would then get an increase in tax revenue from the members and the net result would be an increase in revenue—not from the co-operative itself but from its members? I am not sure that I have made myself clear.

Mr. Dierker: Please turn to the schedule. Unfortunately I do not have my copy. If my memory is correct, the schedule does suggest that there will be a tax raised from co-operatives and credit unions in the order of $1 million. That tax would be raised by simply transferring the tax payment to the co-op as distinct from the individual. At the present time you have to bear in mind that returns on member equity in co-operatives, credit unions and caisses populaires are all taxable. Interest on loans is taxable in the hands of the member, so all distribution is only one exemption, which is consumer patronage refunds in the case of co-operatives. All we have is a shifting of the tax. Then, if you apply any form of integration to the members, the net effect should be the same, to get back to an individual rate of tax.

Senator Carter: If the White Paper proposal is put into effect will it generate more revenue for the Government than the present tax system as far as co-operatives are concerned?

Mr. Dierker: There will be a higher rate of tax on the co-op. I would question whether there would be a net increase in tax revenue to the Government from taxation, because you have to keep in mind that distributions have always been taxed in the hands of

the individual, and there is nothing new in that. The credit union members have always been taxed even though credit unions themselves have been exempt. Have I answered your question?

Senator Carter: Thank you.

Mr. Dierker: The only problem is that we get back to the provincial regulations, and these create some serious road blocks to working out the plan envisaged by the Government.

The Acting Chairman: Are there any further questions?

Senator Molson: I would like to ask these gentlemen this question. In view of the fact that they represent 2½ million members, have they any views to express on the White Paper, other than the few paragraphs particularly confined to the operations of their credit unions? Your 2½ million members are going to be affected as much as any other individuals in Canada, by changes in taxation. I was wondering if your appearance here contemplated any expression of opinion on any of the other points that are merged in the changes in taxation proposed under the White Paper.

Mr. May: Mr. Chairman, rather specifically we have no further considered views on the White Paper proposals other than those we have mentioned specifically in our brief. I would indicate, however, that a number of our individual credit unions, who have participated in many organizations, have made known their views under different aspects of the White Paper proposals. But collectively we have not made any considered views.

Senator Molson: You have not considered the points of whether taxation on a gain on principal residence, or a five-year re-valuation, or capital gains per se, or split taxation for small businesses, or any of these other points?

Mr. May: Not specifically, senator.

(Senator Salter A. Hayden resumed the Chair)

The Chairman: I guess the shoemaker is going to stick to his last.

Senator Molson: It is a very large membership and we would have been extremely interested in your views.

The Chairman: It may be we could get a view. You deal in money?

Mr. May: Yes. These would be personal views.

The Chairman: You know the scheme in the White Paper under which they take 750,000 people off the tax rolls by increasing the exemption for people who are single or married status. The loss of tax revenue arising out of that is somewhere between $30 million and $35 million.

Then they go ahead and grant the increased exemptions to every taxpayer. Then there is another group, between the level of those who are excused, the 750,000, where the single man gets the increased exemption, which exposes him to less tax, and that holds good for a single person until he gets up to a little over $6,000 of taxable income. By that time he is at a break-even point, because the benefit of the increased exemption has been taken away. For a man of married status the figure is about $9,300.

Then, when you move up into the next group, which a lot of people call the middle income group, that is where the socking process really goes on. From there to $25,000 is where the inroads are the greatest in increased taxation. I was wondering if you people had any view. If you only wanted to take 750,000 people off the tax rolls, that could be done very easily. It maybe they should not be on there, having regard to the level of income. If you just took them off the tax rolls by saying that income after all deductions under the act—you do not talk about exemptions at all—you just say, after all deductions under the act, where income is not more than $1,400, it is non-taxable for a single person and for a person with married status, $2,800. Then if you did not touch the exemptions, if you did not increase the exemptions the rest of the way along the line, obviously you would have to find a lot less money. Instead of the billion dollars of revenue that they are talking about losing, you would have only $30 to $35 million.

I wonder what would your view be of the attitude of taxpayers if you were going to deal in that fashion. You are preferring certain categories. What do you think the reaction would be?

Mr. May: Mr. Chairman, perhaps we have had some uncollective thoughts about this. Perhaps Mr. Graham could express his first. I do not know whether we can go into much detail.

Mr. Graham: You should ask me, sir, first about bringing into income of the amounts of money in

professional fees that have never had to be done except on a cash basis.

The Chairman: Do not worry. I will.

Mr. Graham: Mr. Chairman, the general observation which I have read—and this is a personal observation—from the general reading I have seen on this, I think the first thing is that it is an unfortunate suggestion. There is the suggestion, of course, that we are having tax reform and at the same time as we are having tax reform we have tied in with that tax reform a general increase in income tax. I think that is most unfortunate.

I look at these increased exemptions, and to me these—I am now thinking of my family, my children who are married, and I look at them, in the province, and I think these increased exemptions are somewhat illusory.

The general level of income is generally going up and I suggest to you that by the time the five years are up the people who are supposed to benefit will not benefit at all. If the whole thing is going to be on a tax basis, it will all be eroded in that case.

The Chairman: You realize that, in connection with this White Paper proposal on individual taxation, in the fifth year there will be about $650 million excess in taxes collected, practically all coming out of what we call the middle income group. And that is the savings group. Even Mr. Bryce, when he was here, and Mr. Brown, agreed with us that that is where it was coming from. It is too bad you cannot do something that might be worthwhile and yet not impose a lot of penalties because you are acting like a prima donna, it may be.

Mr. Graham: Between that and the estate taxes, one begins to wonder what is the proper disposition of your assets.

Senator Molson: What you are working for.

Mr. Graham: I agree.

Senator Molson: Could we ask also about the small business aspect?

The Chairman: Yes. If you were asked to define "small business", how would you define it?

Mr. Graham: Perhaps I could put this to you, that in my audit, going around different companies, I do quite a few commercial companies. I look at the type of business that has been created over the years, and primarily the whole thing has been built, you might say, on a 21 per cent tax base. It does not create any large fortunes or anything after that style; it creates a nice business that provides employment for a lot of people. I seriously wonder what that type of person would do if he had to start now on the present basis of 50 per cent. I am thinking of the printing firm, for example, when it has to make all the investments in machinery and that sort of thing. How would such a business get started? I don't know how they get started any more.

The Chairman: Just leaving that aspect for a moment, how do you measure what a small business is? Would you define it by net profits?

Mr. Graham: I imagine that is what we do, isn't it? That is what we have been used to.

The Chairman: The Small Loans Act defines it by volume of sales. We put this question to the Retail Council of Canada and they had one member on their panel who had come out from Austria about eight or ten years ago. He and his wife set themselves up in Hamilton in a small gents' wear store in a very small space. I think he said he had 1,000 square feet. He begged and borrowed wherever he could find a few dollars. He finally ended up with three stores, another gents' wear store and one ladies software. He now has 12,000.

I put the question to him and he said it should be defined in relation to net profits, because in some lines that small businesses engage in the profit is very small and you would have to have a very substantial volume of sales to reach a figure of, say, $50,000 or $75,000 of net profit. In other words, the sales might have to be in the order of $1 million to do that. He said that that is big business anywhere. It is just that in the particular field you don't make much money out of it.

We are exploring the idea of whether there should be a separate category for small businesses. Perhaps they should not be in the category of closely-held corporations. Maybe we should not make any distinction between "incorporated" and "unincorporated". After all, the White Paper has some fictions in it; so why couldn't we put in another fiction. We could say the rate is 21 per cent regardless of whether it is a partnership or is incorporated, and you pay that and that is it, up to the $35,000 limit.

Senator Molson: And then you would have the notch provision.

The Chairman: The notch provision? No. I have been sort of getting away from the idea of a notch, because they have lived with the 21 per cent rate on the first $35,000, and what they are asking for is to be put back in that position.

Senator Molson: Agreed. I thought we had to have a transition somewhere, though, up to some mythical figure such as $65,000 or $75,000.

The Chairman: The only thing we are thinking about is that you might define a small business by saying it is a commercial or a manufacturing or a service-operating business having net profits of not more than, say, $60,000 or $75,000. Certainly not more than $100,000. If businesses fit into that definition they then have 21 per cent tax on the first $35,000 and you lift them out of the closely-held corporation category.

Senator Isnor: In the case that you suggest, the turnover would be well over $1 million.

The Chairman: In certain lines, such as software and things of that sort, it would certainly be over $1 million, and you are getting too high for that description, perhaps. But it may be that the level is $50,000 or $60,000 or anywhere up to $75,000.

Mr. Graham: I don't know how you bring the "unincorporated" business in. That interests me.

The Chairman: It is simple. In the White Paper they say you have a partnership option.

Mr. Graham: But you lose your 21 per cent. You go then with the personal rates.

The Chairman: No. If you read that section on the partnership option, all it means is that if you are incorporated you can elect to be taxed as a partnership.

Mr. Graham: That is right.

The Chairman: And you are taxed and the company pays the tax and that is all there is to it. It is a fiction.

Mr. Graham: But there is no 21 per cent rate. That is what I am suggesting to you.

The Chairman: Well I am suggesting the other kind of fiction; that is, give the 21 per cent rate to the incorporated or unincorporated. Have just the one rate, and after they have paid their tax the money is theirs to do with as they will. No doubt their purpose would be to retain it in their business, because the capital markets are not open to that.

Would you say there is need in the small business, as we have been defining it, for capital assistance in the only way in which they can get it, and that is out of retained earnings: Would that be your experience?

Mr. Graham: Yes.

The Chairman: We had the B.C. Forest Products Association here, representing perhaps thousands of small operations out west, and they told us that their only real source of capital expansion or acquisition of equipment or anything of that kind was from their own retained earnings, and they produced statements to show how, because of that limitation, they were not able to compete on the same basis as their American counterparts.

Mr. Graham: Especially when you look at the absorption by the larger companies, the smaller man does not stand a chance.

The Chairman: Mr. Graham has been rather nice to us. Perhaps he should have a chance to give us his opinion of the professional accounting on an accrual basis.

Mr. Graham: We will never keep any records. No costing.

The Chairman: I beg your pardon?

Mr. Graham: No costing. We won't know any costs until we send the bill out. I find it very difficult to know how you would place a value on what you have done to date.

The Chairman: You spend a couple of hours today and it may be a year before the thing has crystalized and you send out a bill. How can you say that that time you spent today is inventory? It bothers me. I thought you might be able to help us.

Mr. Graham: It bothers me too, sir. How I am going to collect it a year from now is a good question.

Senator Phillips (Rigaud): Mr. Chairman, before these gentlemen leave, I am not sure whether we are

clear on the following point: with respect to the co-operative union this morning we asked for a comparison by taking a particular representative company in respect of whose earnings we wanted a schedule which would cover the following: one, the tax which they are subjected to under the present law; two, the tax to which they would be subjected if the suggestions of the White Paper were implemented—and the assumption is, of course, that you understand clearly what those suggestions of the White Paper are. I am not trying to be facetious in saying that, because you must make some assumptions of what you think the White Paper means to say so that the second point, or perhaps I should say second column, would be an indication of the taxes due on the assumption of the provisions of the White Paper being implemented. The third column would indicate to us what the tax would be for that year if the suggestions made by the co-operative union were implemented.

That is what we did this morning. Now, Mr. Chairman, what I should like to ask for specifically is not a consolidation of all the companies, but rather a typical case. It would be more helpful if we asked the gentlemen before us now to take a typical 1969 credit union company, one that was as closely representative of the over-all activities as possible, and deal with the subject matter in the same way as I have referred to with respect to a typical co-operative.

The Chairman: Except that all you would get in the first instance would be their 1969 financial statement. There would not be any tax in it.

Senator Phillips (Rigaud): That is right. Whatever it is. Their 1969 financial statement would do. We would get the statement plus a column for purposes of a quick comparison of what the tax is, if any, and then the next column would be the tax based upon the White Paper implementation and, third, the taxed based upon your recommendations.

I think if we received a pilot report on that similar to the co-operative union it would be helpful to us.

Mr. May: Mr. Chairman, we shall do our best to make that available.

The Chairman: I think there is some value in our getting it as soon as we can.

Mr. Ingram: Mr. Chairman, may I point out that we would have to base our consolidated pro forma statement on the assumptions that are in the White Paper.

The Chairman: As long as you state your assumptions in the paper you write to us, as to the interpretations that you have made.

Mr. Graham: I think our biggest difficulty in this is going to be the word "comparable". Credit unions should be allowed comparable reserves to banks, but the meaning of the word "comparable" I dont' know. We know what our situation is on a provincial level. We know the difficulties we will face if comparable is to be something less than on the provincial level, we will be hampered by the provincial statutes.

The Chairman: Well, if it were something more—maybe on the banking level.

Mr. Graham: We can do this. It will be just a schedule.

The Chairman: Any other questions to be asked of these gentlemen?

Thank you very much.

Now we have La Fédération des Caisses Populaires Desjardins.

Mr. Charron.

M. P.E. Charron, Directeur General, La Federation des Caisses Populaires Desjardins: Mr. Chairman, honourable members of the committee, at the outset let me express to you our thanks for this opportunity to meet you and to present to you our remarks, views and commentaries on the proposals in the White Paper concerning co-operative and savings societies in Quebec.

[*Translation*]

First of all, I would like to thank you for this opportunity of meeting with you to express our opinion on the proposals made in the Benson Report, particularly those which concern Caisses Populaires.

It gives me great pleasure to represent the Quebec Federation here, for the regional unions of the Desjardins Caisses Populaires, as many of you already know, whose founder is a former colleague of yours, Senator Vaillancourt, who established it in 1932 and headed the operation for more than 35 years. One could say, it is very much his achievement.

Thus, I have the honour of representing here the Quebec Federation of Desjardins Caisses Populaires, comprising at present 1310 Caisses Populaires in

Quebec, with a membership of 2½ million and a working capital of $1,900,000,000.

Senator Desruisseaux: May I ask you whether your 2,500,000 members belong to one of the Federation organizations?

Mr. Charron: Of our Federation, yes.

Senator Desruisseaux: But there was a group announced this morning, representing 2 million and some hundred thousand, as well as a group of one million several hundred thousand; are they separate?

Mr. Charron: Yes. The Quebec Federation of Desjardins Caisses Populaires includes at present, 2,500,000 members, and two other federations in Quebec are allied with us in sympathy with our point of view, to endorse or support our report; they are the following: *La Fédération de Montréal des Caisses Desjardins*, representing 33 Caisses Populaires, with a membership of 150,850 and a working capital of $161,697,000 as of December 31st, 1969, and *La Fédération des Caisses d'économie du Québec*, which are cooperatives, whose credit is governed entirely by the Quebec Savings and Credit Unions Act. This third federation, then, *La Fédération des Caisses d'économie du Québec*, is composed of 150 savings unions, with a membership of 120,720 and a working capital of $174,657,000 as of December 31st, 1969. These three savings and credit union federations represent 95 per cent of the Desjardins Caisse Populaire and credit union manpower strength in Quebec.

You may have heard of others, but they represent other provinces in Canada.

Caisses populaires, as you know, are savings and credit cooperatives, at the exclusive service of their active membership, which is in effect the owner. There is a single identification of the owner, the user and the beneficiary due to the fact that the savings and credit cooperative is actually two cooperatives in one.

Up until now, they have been exempt from taxes on their annual operations overcharge kept on reserve. Though the Caisses populaires are not in agreement with the particular treatment given them in Benson's White Paper on tax reform, they nevertheless approve of the general proposals for integration set forth in it. For this reason, they are subscribing to the proposals made in the joint report of the Co-operative Union of Canada and the *Conseil Canadien de la Coopération*, calling for an individual tax treatment of the co-operatives, which respects both the basic principles of the Minister of Finance, Mr. Benson's White Paper, and the characteristics of a co-operative, and I would stress this point: savings and credit unions are a form of co-operatives.

Caisses populaires are savings agencies at the service of their members; they act solely as a legal intermediary, the same as a corporation, between their borrowing members and their lenders, who in effect, are the depositors. The firm registers the deposits and the loans, and then, at the end of the year, it distributes the over-charge in order to bring the operation back to cost, since it is a co-operative. There are not three factors or agents, re a seller, a buyer and a broker, who absorb the difference, no; this is no third party in the economic sense, but rather in the legal sense, in that it acts for and in the name of its members; this is why we say it is a collective agent acting for and in the name of its members, who in effect, are the owners, clients and beneficiaries. Thus, a single definition; it is physically impossible to make a profit from yourself.

Caisses populaires, which are under provincial law, have always operated with the realization that they are a source of income for their members, and that this income is taxable in their hands. They wish to stress that they agree with the basic principle of the Carter Commission, which is repeated in Mr. Benson's White Paper, of taxing a firm's income only once, and at the rate paid to those to whom it belongs.

The specific tax treatment proposed for Caisses populaires in the White Paper does not tie in with the proposals for tax reform with regard to corporations and their shareholders. Based on the strange notion of a high return on the capital employed, this particular tax treatment poses more problems than it solves; it completely ignores the fact that Caisses Populaires must have sufficiently large reserves to insure the stability of their operation, since they are a public institution, as made evident in the size of their membership totalling 2,500,000 in Quebec, and do make personal loans to persons earning less than $4,000 a year to the extent of at least 36 per cent. Thus, I feel that this underlines the popular character of the undertaking, due to the modest sums involved in the savings which they are constantly using. Thus, you can soon figure out that the average savings deposits are small, and the loans too.

We would add our voice to the joint report of the Co-operative Union of Canada and the *Conseil Canadien de la Coopération* to ask that co-operative

corporations which are collective corporations be given a special tax treatment which would respect both their characteristics and the principle of taxing company income only once, and at the rate paid to the people to whom the income belongs or is distributed. With this kind of tax treatment, the Caisses Populaires would be able to continue to distribute most of their overcharge as profit or interest on the registered capital or savings and as dividends, rebates, interest adjustments and their reserves would be taxable at the average rate for residents of Quebec. We feel that this would be a fair treatment of the savings and credit cooperatives. In a sense, this is our product.

Senator Beaubien: Mr. Charron, at the present time, or in 1969, did you not pay any taxes on the income from the Caisses Populaires? I mean, the Caisses Populaires have not paid any taxes to date.

Mr. Charron: Under current law, Caisses Populaires are exempt from taxes if their income is derived primarily from loans to their members,–and income from provincial and federal government bonds which are guaranteed by the respective governments, is included in this interest on loans to members, since the Caisse Populaire is a Desjardins co-operative; but they are required to have a certain percentage of ready money,–and it is still felt that the best liquid assets are Canadian Government bonds.

Senator Beaubien: This is still widely held?

Mr. Charron: Yes, in spite of possible complications,–also Quebec bonds, as well as bonds of corporations owned by both governments, which eventually came to be included as income. In reality, the Quebec Caisses populaires do not pay taxes because they respect their co-operative role and because they make loans to their members from which they derive their main income. By this very fact, they are exempted from taxes–in effect.

Senator Beaubien: Mr. Charron, what changes do you think the White Paper will bring? Will there be a big difference in your operations? How would you be taxed under the White Paper?

Mr. Charron: Yes, well, that depends where you would put us in the White Paper, since there are three categories of corporations in it: non-collective corporations, closely-held corporations and widely-held corporations. As for us, we consider ourselves distinct from all of these groups because of our special characteristics. Moreover, what we are asking,–in a manner clearly understandable by all, nevertheless,–what we would like is to be given a separate category which would recognize the special corporate status of our operations, or, simply, a corporation which would act as a collective agent for its members, but which would pay the same taxes as its members would if their reserves had been distributed to them, according to the law.

Thus, basically we go along with the general objectives of the Benson Report. We feel that it has been an effort to make a classification of all institutions, of all types of corporations, in furtherance of the principle of the Carter Report, which states that an economic or financial advantage is only taxable once; if the corporation does not pay, the individual does, and vice versa. Thus, it is the corporation who pays. As for us, we have to have reserves, since it must not be forgotten that we have registered capital which remains with us, just as in the banks; we have to pay interest on it, so we cannot give it a plus value, as in the corporations. And, we have 500 locations in the province of Quebec where there are no bank branches, most likely because it is not practical from the point of view of profitability; thus, we are dealing with people who would otherwise have been deprived of the service. We even have Caisses Populaires among the Eskimos in the North, which are costing us an arm and an leg, if you'll pardon the expression, but they have a right to the service so we give it to them, knowing the expense. In a manner of speaking, it is a way of paying taxes.

[*Text*]

Senator Desruisseaux: Mr. Chairman, I should like to ask a question for the purpose of clarification. You mentioned rather proudly that you have 2,500,000 members in Quebec, and that they have been acquired over a relatively small number of years. What would happen if we all became members of co-operatives? What would happen, in your view, in respect of the Government's obtaining money? Has that possibility ever been analyzed? What would happen to the Government if we all became members of co-operatives? From where would the Government get its money?

The Chairman: It would not have to spend any money, and, therefore, it would not need it.

Mr. Morin: Senator Desruisseaux, I do think the hypothesis is a very dangerous one. If the total

population of Quebec became members of the caisses populaires, then, of course, the caisses populaires would have to adjust to the situation, and give all of the services that the banks are giving right now. The would mean an evolution right there. If your main problem is taxation then I suppose too that the caisses populaires would have to pay taxes, but you would have all of the population as members and just not people with low incomes, and probably they would have enough revenue to pay the tax and to continue to expand.

Senator Phillips (Rigaud): As I understand it, Mr. Morin, Mr. Desjardins has taken the position that you took this morning that the caisses populaires are really the agents for the individuals.

Mr. Morin: Yes.

Senator Phillips (Rigaud): And if we are to have a simplified tax structure there should be no taxation whatsoever against the caisses populaires as a corporate organization because, as he put it, it is "seulement l'agent pour l'individu? "

Mr. Morin: Yes.

Senator Phillips (Rigaud): Therefore, if I follow Mr. Girardin's position correctly, it is in line with what we were discussing this morning and earlier this afternoon, that for the first time we are getting a statement that in so far as co-operatives are concerned, and certainly in so far as La Federation des Caisses Populaires Desjardins and the other two associations are concerned, the position is that there should be no taxation of any nature whatsoever against les caisses, because that would be taxing the individuals.

Mr. Morin: I think that was Mr. Charron.

Senator Phillips (Rigaud): Yes, I am sorry.

Mr. Morin: We should comment on this, We say we should not be taxed as an enterprise in a different manner from our members. In the past we were not taxed and we always fought for that principle.

However, the main idea of the Carter Report was to have the taxation of the enterprise applied just once, at the level of the shareholders to whom this revenue belongs. You do not have double taxation of the enterprise and of the people who receive the revenue.

It is just one tax and all the revenue in Canada is taxed once, and in the end the individual to whom it belongs. Our brief and that of the Co-operative Union of Canada this morning realizes that he should pay tax somewhere, because he is replacing a collectivity.

Senator Phillips (Rigaud): Should not the same argument apply to the co-operatives we heard this morning and the credit unions we heard this afternoon?

Mr. Morin: Yes.

Senator Phillips (Rigaud): That is the point I was trying to get across before, because the co-operative union and the credit unions did not go so far as the caisses populaires are going this afternoon.

I can see the logic of the Carter Report and one tax; I can see the logic of a statement that the caisse is only the agent for the individuals.

Are we being asked as a committee to take a position that co-operatives, credit unions and caisses populaires should not be taxed at all because in the final analysis they are only agents for the individuals and ultimately whatever moneys are distributed from the very beginning belongs to the individuals.

Is that the position?

Mr. Morin: Of course, Senator Phillips, you have the right to say this in view of the services provided by the co-operative system and the caisses populaires, but they do not ask as much as that.

They are agreeing to pay their part of the expenses of the country, but in accordance with their system and the general approach of the White Paper, not the sophisticated system of 8½ per cent on capital employed, which is used nowhere. There is no logic to the general approach.

You are reframing the taxation system. It seems that it is time to reframe this also for the co-op system and the caisses populaires on very logical grounds.

We understand from the Carter Report and the White Paper that all income should be taxed once. We agree with this. The co-operative system says all surplus earnings should be taxed once, either in the hands of the members, if it is distributed, or in the hands of the collectivity if it keeps a part of it in its reserves.

At which rate should it be for a collectivity? We have problems there, because if we were classified as a closely-held corporation, we should pay 50 per cent tax on the funds we place in our reserves. This tax

paid by the co-op system or caisse populaire would be integrated to the distribution of over 50 per cent to our members. But if we began to try this approach we would have two main problems. First, there would be a big administrative problem. We would be obliged to print two and a half million T.5 and T.P.5 forms. That would involve tons of paper, and would cost us more than $½ million to print. Right now we are printing T.5s for 28 per cent of our members, who receive 87 per cent of all the interest we distribute. This figure alone will show that a lot of people in the caisse populaire are low income people, because 72 per cent of our members do not earn $10 interest in a year. If we were held to be a closely held corporation we would have to print all these T.5s, and this would create a jungle of an administrative problem for us, and probably for the Government too.

Secondly, there is a cash flow problem. A closely held corporation, the usual corporation, has the right to distribute in share capital what is is not paying in income tax, and keep the capital working in the corporation. However, for a caisse populaire that is not possible, because our share capital is redeemable on demand. If we were classified as a closely held corporation only, we would have the problem of paying 50 per cent income tax, and the other 50 per cent would be wiped out the next morning. We would therefore not be able to build reserves, which we need, because we operate in many places in Quebec under great difficulties, where we are subject to the hazards of de-population, strikes and unemployment on a local basis.

Senator Phillips (Rigaud): Plus burglary.

Mr. Morin: Plus burglary. We have insurance for this, but that is a problem. We badly need reserves, so what is our suggestion? Our suggestion is that instead of taking the approach permitted by the White Paper for the closely held corporations, and multiplying the T.5s and T.P.5 forms, having an integration of the income tax paid by the caisse populaire to each member, and having each member of the caisse populaire coming back to the Government and saying, "Please give me my return", we should pay tax, but at a collective rate, at the rate of the citizen of one province.

If we were engaging in this battle to manipulate the T.5s and T.P.5s and paying 50 per cent, what would remain in the government? What would remain in the government is probably near what the average citizen is paying as a percentage of his total income. Our suggestion, therefore, is to pay this collective rate on the amount we are placing in our reserves. Let us pay it once, and there will be no application to individual income because it will have been integrated collectively. We say that the caisses populaires are agents working for members and for collectivity. If they distribute the income to the members, the members will pay income tax on it. If it keeps the income as a reserve to protect the collective membership to whom the caisse populaire belongs, the caisse populaire should pay the income tax on it as a collective rate.

The Chairman: Are you subject to the Deposit Insurance Act in Quebec?

Mr. Morin: Yes, we will be.

The Chairman: So you have to pay premiums?

Mr. Morin: There is no premium to pay.

The Chairman: On the basis of the number of pieces of paper you said you would have to send out if they introduced one of the tax methods—two and a half million pieces—the individual bank account must be very much below that deposit guarantee of $20,000. What would your average deposit be?

Mr. Morin: Less than $700.

Senator Burchill: You said your share capital was redeemable on demand.

Mr. Morin: There is a turnover once in four years at the moment. In the past it was once in 15 years. All is going faster now.

Senator Burchill: Not as fast as in New Brunswick.

The Chairman: Maybe they are smart and they invest it.

Mr. Morin: Your question is good, senator. We should note that the shares in the caisse populaire are redeemable on demand. The voting power is one vote for each person. In other provinces the shares do not form the basis for distribution of future surplus earnings. There is no plus value possible on shares. Therefore, for all of these reasons it is very interesting for people to build more and more shares. The closely held corporation has the right to distribute, but that part of our surplus earning which is not being paid in the form of income tax would be wiped out. It is not the basis for the voting power and not the basis for the distribution, and there is no plus value there.

The main objections we have to the White Paper on this subject is that it has said nothing about the question of reserves which the caisse populaire would be able to build. It is saying that we could avoid complete taxation if we were giving eight and a half per cent on capital employed. We should be able to avoid all taxation then. They are saying nothing about reserves and we need these reserves. What will be the tax rate? Will there be an integration possibility? All of this we do not know.

It is very curious, because when the Carter Report came out we heard economists say that it suggested treating the enterprise like the co-operative was treated. It is quite the reverse of what the Canadian Tax Foundation has always asked for the last ten years, which is to have the caisse populaire and the co-operative treated as an enterprise. The Carter Report suggested that if a company is distributing its income it should not be taxed on it, but it, but if it is not distributing its income then it should be taxed on it. You have an indication there of having the co-op system and the other kind of enterprise join together in a very logical approach.

The Chairman: Do I understand you to say that the caisse populaire in some cases have preferred shares?

Mr. Morin: Just common shares.

The Chairman: There is no right to a dividend?

Mr. Morin: There is no right to a dividend.

The Chairman: You do pay money to shareholders in their character as shareholders?

Mr. Morin: Yes.

The Chairman: What do you pay it out of?

Mr. Morin: The average rate paid in 1969 was 6.13 per cent.

The Chairman: I was not asking that question. I was asking, what do you pay it out of, what do you charge it up to?

Mr. Morin: I am sorry, I do not understand.

The Chairman: If you pay a dividend, you have to pay it out of earnings, usually.

Mr. Morin: Yes.

The Chairman: So you pay it out of earnings?

Mr. Morin: Yes.

The Chairman: So, to the extent that you have dividends, you have earnings?

Mr. Morin: Yes.

The Chairman: And, having earnings, have they gone through the wringer of taxation?

Mr. Morin: As Mr. Charron said, a moment ago, we are receiving earnings from members, because there are borrowings and we have to give back those earnings to other members because they are members who are depositing.

The Chairman: But you give some in the form of dividends, and to the extent that you give them in the form of dividends, is that not out of profit?

Mr. Morin: Yes, and in English you are calling that a dividend. In French we have a very nice word for it. It is "boni". That is exactly to specify that it is not exactly the same thing.

The Chairman: Why not call it "dividend"?

Mr. Charron: It is a question of semantics.

Mr. Morin: It seems to me that on dividend there is a right there to the shareholder who receives dividends from his company. I am not a lawyer. Perhaps I am wrong. No?

Senator Molson: No.

The Chairman: Unless you write it into the terms and conditions. It usually says that dividends are payable as and when declared by the board. All I am suggesting is that if you go through the formality of declaring a dividend, the ordinary declaration is that out of the profits and surplus of the company, being sufficient to pay this amount of money, why then you declare a dividend. That is why I asked you, what do you pay it out of, if it is not out of earnings?

Mr. Charron: The answer is, interest on shares. "Boni" is declared by the membership at the end of the year, according to the surplus.

The Chairman: I think you had better start calling it something other than a dividend.

Senator Phillips (Rigaud): I think the theory is that the co-operatives always emphasize the different character of their operation and on the cash flow any excess over and above expenses is deemed to be one of these social credit surpluses that are available for distribution to participants rather than a yield on investment.

The Chairman: This is an honest to goodness piece of paper.

Senator Beaubien: The share is a sort of deposit.

Senator Phillips (Rigaud): As Mr. Charron said, it is a matter of semantics.

The Chairman: It may be a matter of semantics, but the fact that you do call it a dividend might create some problems for you.

Senator Molson: It is disposable wealth.

Senator Phillips (Rigaud): As Senator Molson said, an "actif disponible". May I put another question to the gentlemen, a request rather than a question? We are going to obtain from the co-operatives and from the credit unions a comparison along the lines with which we sre now familiar. Cluld we take one of these three constituent bodies here? Let us take the smallest of the three, say La fédération des caisses d'économie du Québec and take their year in 1969. Let us see what they made in 1969, that is to say, the part that was not distributed, what would be the tax now, on the White Paper, and what would be the tax on the basis of your suggestions? So that we will have from the caisses a comparison similar to what we are getting from the co-operatives and from the credit unions. Are you able to do that?

Mr. Charron: My answer to this question right now, senator, is that as to the actual taxation of Caisses Populaires, there is no taxation, so the answer is Zero. The taxation according to the White Paper—here we are obliged to give 8½ per cent interest on the capital employed. If you consider that the capital employed is the share capital subscribed by the members, plus their reserve—if you consider this as the capital employed—you will see that we will need all our surplus earnings to give this interest.

Senator Phillips (Rigaud): But we want to get the figures, Mr. Morin.

Senator Beaubien: He won't have any. He is going to use it all on the 8½ per cent.

Mr. Morin: I am told that the figure is $180 million, Senator Phillips, and on reserves is $85 million. The total is $265 million. At 8½ per cent it would mean $22.5 million of interest to give back to our members. I suppose that we will give back to the shareholders according to the importance of their shares. That would be the only door that we would have. At this moment, if we are giving this $22.5 million to the share capital, it would mean an interest of 12.5 per cent on the share capital, that is, again, share capital redeemable on demand. We are out of the market right now and we have used all our surplus earnings to pay this interest.

Senator Phillips (Rigaud): Your point is that if the recommendations of the White Paper were to be implemented it would wipe out the operations of les caisses populaires.

Mr. Morin: It would wipe out all our surplus earnings. We would stay with the reserve we have right now and with the development of the caisse populaire it would be a very dangerous case. Sure, this is true.

Senator Phillips (Rigaud): That is what I wanted.

Mr. Morin: On individual cases we would arrive with an interest of 28.5 per cent, and we have figures here for caisses populaires having important reserves and not very important share capital. So this question of 8½ per cent on capital employed is not working at all.

Senator Phillips (Rigaud): I am a Quebecois and I am interested in what you are saying. I am trying to get that on the record. You would regard it as absolutely disastrous.

Mr. Morin: Yes. We agree.

The Chairman: Mr. Morin, does your provincial law, which requires the creation of these reserves, make those reserves the property of some body other than the caisse populaire the moment you have put them up or contributed them?

Mr. Morin: Our provincial law is asking us to place at least 10 per cent of our surplus earnings in reserve by

by-law. We ask ourselves to place in these reserves at least 30 percent of our surplus earnings. In practice we are placing there a little bit more than 40 per cent of our surplus earnings. These reserves are the property of all the collectivity. They are indivisible and in the event of a wipe-out these reserves would not be distributed to the members. The reserves would be allocated to a special body of the government.

The Chairman: This is what I wanted to know.

Senator Beaubien: The government would put its hands on it, but quick.

The Chairman: The moment you put the money into the reserve as required by law there is no occasion on which you can take it back for your membership.

Mr. Morin: I agree.

The Chairman: Is that right?

Mr. Morin: That is right. There is no pecuniary interest to our members to place a part of their surplus earnings in their reserve. If they are placing amounts in their reserve it is just to protect their collectivity agency, their organization.

Senator Molson: They can never benefit from it.

Mr. Morin: They can never benefit from it, no.

Senator Isnor: Mr. Chairman, I am not clear in regard to the surplus amount. What is the surplus that you have on hand at the present time?

Mr. Morin: At the end of 1969 the surplus was $21.2 million.

Senator Isnor: You used the term "rebate" and the term "dividend". What is the difference? How do you define "rebate"?

Mr. Valbert Dugas, la Federation des Caisses Populaires Desjardins: It is just a matter of where we stand with the terms. We use the word "dividend" because we use the word "shares", and in the common language shares and dividends go together. That is why we use the word. But definitely a share in the co-op movement is not a share as in the stock company. So they are of a different nature. They are of a totally different nature. That is so far as the dividend is concerned. We use the word "rebate" for the rebate that we can give to the people who use our credit. Let us say, for example, that a man borrowed $1,000 and we charged him 7 per cent. At the end of the year we say, "Well, we charged you one-half of 1 per cent too much" and give him a rebate on his interest. Does that answer your question?

Senator Isnor: Mr. Chairman, are we to have the statements which were requested by Senator Phillips?

The Chairman: Yes, we are going to get them.

Senator Isnor: But are we going to get the third one that was requested?

The Chairman: Well, the matter is on record now.

Mr. Dugas: We will send it in.

The Chairman: Honourable senators, we will meet again tomorrow morning at 9 o'clock. I think you will find it a very interesting meeting. First we will have Massey Ferguson at 9 o'clock and then the Canadian Federation of Agriculture. Then we will have the League of Concerned Canadians—that should include all Canadians—and then we will have the Kiwanis Club of Montreal.

The committee adjourned.

APPENDIX "A"

Molson Industries Limited
Submission on
White Paper on Tax Reform
to
Standing Committee on Banking, Trade and Commerce
of The Senate
and
Standing Committee on Finance, Trade and Economic Affairs
of House of Commons

Ottawa, Ontario
May 1, 1970

CONTENTS

Section A - INTRODUCTORY SUMMARY

1. This submission sets out the views of the management of Molson Industries Limited on how proposals contained in the White Paper on Tax Reform might affect the national economy, the operations of the corporation, the welfare of its employees and shareholders and the future ability of Canadian corporations to compete effectively in international trade.

2. While a main intent of the submission is to deal with the anticipated direct impact upon the corporation, the sweeping nature of the White Paper proposals affect so much of Canadian life that it is often impossible to separate the effect upon the individual from the effect upon the company or the national economy.

3. In some cases, the impact upon individuals could have a delayed, but significant, impact upon the corporation. For example, the possible decision of a number of highly-skilled managers to seek employment in the United States because of a more favorable personal tax structure and greater opportunity for advancement, would have a significant effect upon the company's ability to compete in the future. Because of such possibilities we feel it prudent for us to comment even on personal income taxes and all the proposed capital gains levies.

4. Additionally, the comprehensive nature of the White Paper proposals has sparked one of our greatest national debates. In the light of this debate, and because of the impact the proposals would have on national growth, the company believes it would not be using the analytical and professional skills of its management and tax advisors to the best national advantage, if it simply restricted its submission to the narrower confines of purely corporate activity.

5. In our analysis of the White Paper's proposals, we have tried to be as objective as possible. We have endeavored to keep our comments impartial and non-partisan. They are directed towards what we believe to be best for Canada and for all Canadians.

6. We have been handicapped in our analysis to some degree, because we feel we do not have all the information necessary to make real judgments and because the accuracy of some of the information that has been provided in the White Paper is open to question.

7. Wherever possible we have provided an alternative to any proposal we have criticized. However, we do not see how small, isolated management groups, such as our own, with limited information and even more limited time, can be expected to provide meaningful alternatives to proposals which have been several years in the making and have involved uncounted numbers of tax experts.

8. We feel that the most that can be reasonably expected of individuals and individual corporations is intelligent comment, objective criticism and analysis, made in the light of personal experience. In this context we have, where practical, offered alternatives.

9. A handicap to the provision of meaningful alternatives is the "domino" aspect of the problem. Many of the proposals in the White Paper are so interrelated that it is difficult, if not impossible, to make changes in one area without incurring changes in several other areas. This does not mean that such changes should not be recommended or made. It means that it would require far more time than is available to us, for us to begin to determine the total ramifications and full impact of many of the proposals.

10. This is one reason for our recommendation that any tax changes should be introduced in stages over a much longer period of time than is contemplated in the White Paper.

11. Another reason is that many of the major problems inherent in the White Paper will not be identified until there is an attempt to make its proposals work. This, we believe, could have disastrous consequences for Canadian business, particularly in view of the fact that so many major problems arising from the White Paper have already been identified, and solutions for many of these problems have not yet been found.

12. While we have made suggestions and offered alternatives to some of these major problem areas, we do suggest most strongly that it is not a change in tax mechanics or technicalities that is required, but a change in tax and national philosophy. While we agree that the elimination of tax inequities is important, the creation of a climate for wider opportunities for individual, corporate and national economic advancement is of even greater importance.

13. We regret that we do not believe that the White Paper proposals will contribute to such a vital objective.

14. We accept that all taxes have social effects. Tax reform, therefore, could of itself be expected to bring about some changes in the social structure and, perhaps, be designed to induce some level of social reform. The White Paper, however, has tipped the scales so far in the direction of social reform and equity that its social purposes are in conflict with Canada's economic needs.

15. It has lost sight of the fact that social reforms cost money and that tax reform, to be effective, must continue to encourage growth. The White Paper, unfortunately, appears directed more towards the redistribution of national wealth than the creation of new national wealth through economic growth. Using the more homely example of the tax pie, the White Paper would seem to be primarily concerned with new methods of dividing the pie, rather than increasing the size and quality of the pie itself.

16. The proposals of the White Paper appear to have been developed in isolation from the realities of the tax needs of Canada's provinces and municipalities, of the realities of international commerce and the factors which contribute to real national growth.

17. In too many cases, the government seems intent upon penalizing, or punishing, all Canadian taxpayers because of the apparent ability of a few to queeze through loopholes in current tax legislation.

18. It could be said that the government appears to be hunting mice with elephant guns. We do not support tax evasion or tax loopholes of any manner, shape or form, but we suggest that the government's first consideration should be the welfare of all Canadians. We believe that the government's objectives can be achieved without enveloping all Canadians in a morass of new regulations and restrictions, which will produce only minimal revenue.

19. We find it unfortunate that a government proposal, which purports to promote equity and fairness in taxation, in application would discriminate against so many Canadian taxpayers.

20. It would, for instance, discriminate:

- against the shareholders and employees of a widely-held Canadian company in favor of the shareholders and employees of a closely-held company

- against the shareholders and employees of a Canadian-chartered, Canadian-based, Canadian-managed and Canadian-owned company which operates, in part, outside of our national boundaries, in favor of the shareholders and employees of Canadian-chartered and Canadian-based companies which operate inside the national boundaries, whether or not they are Canadian-owned and Canadian-managed.

21. It would appear that the government has become too preoccupied with its concept of "fairness", to the detriment of the economic development of Canada. In the final analysis we believe the choice will have to be: Which is "fairest":

- to continue the economic development of Canada at a rapid rate with the result that the real income (after taxes) of all Canadians is enhanced and improved, even though those who take substantial capital risks may be rewarded at a higher rate commensurate with the risk taken, or

- to impede economic development with a taxing structure that does not offer substantial rewards for substantial risk, but does distribute the tax burden in a fashion which may appeal, in the short run, to a large number of voters who do not realize that their future real income may well be in jeopardy?

22. A report, published by the Ontario Economic Council in November, 1969, sums up the choice this way:

"Economic growth is not, of course, an end in itself. It is, however, vital to the achievement of most of the real goals of our society. The maintenance of our political independence, the preservation of our national unity, and the economic welfare of our citizens all depend, to a considerable extent, on the health of the economy. Other social objectives, such as the elimination of poverty, the reduction of regional disparities in wealth and opportunity, provision of adequate housing, medical care and old age security, can be obtained without suffocating the economy, only from the fruits of an expanding economy."

23. Rather than expand the economy, we believe that, if enacted, the White Paper proposals will:

- add fresh and highly-volatile fuels to the fires of inflation,

- hasten, and make easier, the take-over by foreign commercial interests of Canadian corporations. The alternative will be legislation against sale to non-Canadian investors and this will mean virtual isolation from the rest of the trading and investing world

- unnecessarily handicap Canadian companies in their efforts to become significant elements in international trade

- provide the federal government with revenue increases on a carte blanche basis without taking into account the needs of provincial and municipal governments

- reduce the flow of foreign capital to support Canadian projects

- unnecessarily burden many Canadians with higher taxes and thereby reduce personal incentive

- increase the emigration of talented Canadians to the United States and reduce the flow of managerial and professional talent to Canada from the U.S. and other countries.

24. The changes in the White Paper are so vast and so complex that it is, in our opinion, too much for the government to expect that they can be instituted overnight. We strongly commend to the committee that it consider, with all urgency, the proposals, made by men of stature in the tax field, that tax reform be introduced in stages and spread over a number of years. Reform of the tax system in stages would permit careful consideration of <u>all</u> changes and enable them to be worked into the socio-economic structure with a minimum of disturbance.

25. We understand that the White Paper proposals would have to undergo major revisions to permit the introduction of its practical

proposals in stages over a period of time. However, we believe that the small loss of time and revenue that would result would be minor compared to the losses and confusion that are likely to occur if an attempt is made to introduce a total tax reform package in one move.

26. We recognize it is possible that the cumulative effect of our suggestions will reduce the federal tax revenues below those proposed in the White Paper. We do not have the base figures and assumptions used by the federal government in its calculations, so we have no real method of determining the revenue impact of our proposals. However, we believe the national need for the greater development of the personal, corporate and national economies is more pressing than the need for additional tax revenue -- particularly when the need for such revenue has not been established.

27. We present below for the benefit of the committee, a summary of suggestions and proposals, some of which are offered in other sections of our submission.

28. We recommend:

- a tax philosophy which recognizes that personal initiative and enterprise on a large scale is the real source of national growth, and a tax policy which provides the incentives -- instead of disincentives -- for such initiative and enterprise

- a tax philosophy which recognizes Canada's urgent need to expand its activities and influence in international trade, and a tax policy that aggressively supports -- rather than inhibits -- such expansion

- better control of current costs and expenditures and establishment of future fiscal priorities, by the federal government

- total coordination between federal, provincial and municipal governments before finalization of tax reform legislation

- income tax rates should be reduced

- half of all capital gains which are to be taxed, regardless

of source, be taken into income and taxed at personal marginal rates

- tax on capital gain not to exceed an effective rate of 25 percent on the entire gain

- no tax should be levied on any form of capital gain until the gain has actually been realized

- personal residences should not be subject to capital gains tax

- personal assets should not be subject to capital gains tax

- estate taxes should be eliminated if capital gains tax is to include unrealized gains at death

- integration should apply universally to all Canadian corporations, regardless of source of income, <u>or</u>, alternatively, streaming of tax credits should be permitted

- legitimate business expenses in the areas of conventions, seminars, entertainment, sales promotion, and the like, designed to increase business skills and profits, should continue to be allowed

- interest expense for debt incurred for share acquisitions should be deductible

- the distinction between widely-held and closely-held companies should be reconsidered, but if the distinction is maintained, companies should not be precluded from changing from widely-held to closely-held, or vice versa, because of their original status

- the present exemption of intercompany dividends be retained.

Section B - THE CORPORATION

1. Molson Industries Limited is a diversified corporation with major manufacturing and marketing operations in Canada, the United States, Europe and Mexico. The company is one of the oldest, continuously Canadian-controlled corporations in the country. The roots of the original Molson enterprise go back to 1786. The management of the company still includes direct descendants of the founder of the original enterprise. Other corporate elements of the present Molson organization have histories, as Canadian-owned and Canadian-directed enterprises, that go back beyond the turn of the century.

2. The company's sales are approximately $300 million a year. It has 7,600 employees and total assets of approximately $155 million, which include 38 manufacturing facilities, breweries and public warehouses in 26 communities in Canada and the United States. It is owned by some 13,000 shareholders.

3. In its 183 years of growth, the company has established a significant position for itself in the Canadian economy. It is:

- one of the three major national brewers in Canada, with breweries in seven provinces and a significant interest in a U. S. brewery

- one of the four major gasoline pump manufacturers in North America; it has manufacturing facilities in Canada, the United States and Italy with affiliated manufacturing operations in Mexico and Switzerland

- one of the leading construction supply manufacturers and the major supplier of soil pipe, in Canada

- a major factor in the Canadian domestic furniture, office furniture and equipment and school supply industries

- a manufacturer of a wide range of industrial products in Canada and the United States.

- a significant element in the public warehousing and distribution services industry in Canada.

Section C - EFFECT OF INTEGRATION ON INTERNATIONAL COMPANIES

1. We are impressed with the government's intent to persuade Canadians to invest in Canadian corporations. We, however, oppose the effective discrimination against shareholders of Canadian-chartered, Canadian-based, Canadian-owned and Canadian-managed companies which seek to extend Canada's trading influence overseas or in non-Canadian markets.

2. We use the term "discrimination" because, notwithstanding the play upon words in the White Paper and the juggling of "incentive" and "disincentive", the end result is discrimination. We are unable to understand how preference can be given to one form of investment without discriminating against other forms of investment.

3. This discrimination arises from the government's proposed treatment of income derived by a Canadian company from foreign operations. The proposal fails to give credit to Canadian shareholders for the foreign taxes paid by the corporation, in the same manner as is proposed for Canadian tax paid on income derived from Canadian sources. This failure to give tax relief will have the effect of penalizing Canadian enterprise and can only work to the benefit of the country's international trading competitors. It will, in the long term, injure all Canadians because of a potential loss of international trade, and it will, in the short term, obviously penalize many Canadian shareholders.

4. The proposed discrimination is doubly difficult to reconcile at a time when trade has so obviously become more international and more of the world's commerce is being undertaken by international or multinational companies. This continually evolving condition, with its significance to balance of trade payments, has been recognized by the governments of many countries. They are actively encouraging corporations of their countries to become larger participants in international trade.

5. In view of the limited number of Canadian companies involved in international trade, and the competition they face from American, European and Asiatic multinational companies, it is unreasonable for the Canadian government to place further obstacles in the path of Canadian companies.

6. The proposal will, unfortunately, hurt most those companies, such as ours, which are still establishing themselves in foreign markets. These companies can only hope that their shareholders will accept a government tax penalty as a just reward for supporting a venturesome, aggressive management.

7. The necessity "to go international" is induced in many growth-oriented Canadian companies and Canadian entrepreneurs by the limited size of the domestic market. The fact is, that once Canadian corporations grow to a size which allows them to feel comfortable competing -- even in their own market -- with some of the industrial giants of the world, they begin to bump their heads against the constraints imposed by the smallness of the Canadian market. It becomes obvious to any aggressive manager that, unless he looks outside the national borders, there is a ceiling on the growth of his company.

8. It cannot possibly be the Canadian government's intent to restrict the movement of Canadian companies into the international and multinational corporate world. To do that would be to ensure that in future decades the small Canadian enterprises encouraged by such a policy would become branches of the multinational operations of corporations of other countries. Alternatively, we will be sitting within our own national boundaries bartering among ourselves, isolated from world trade.

9. The United States, for instance, already has its large international or multinational corporations in abundance. They are the result, not only of the size of the U. S. economy, but also of federal tax encouragements given U. S. companies in years past. It is, therefore, incomprehensible that the Canadian government would consider the imposition of tax-shackles on Canadian companies at a time when they need all the encouragement they can receive from Canadian governments to aid them to become firmly established as strong, viable competitors in the international marketplace.

10. The government, without acknowledging the growing worldwide trend to international and multinational operations, does agree, in the White Paper, that:

> "Canadian business is often required to go abroad to seek foreign sources of supply and to develop foreign markets. Going international is frequently necessary to enable Canadian companies to achieve the economies of scale which are otherwise denied them by the relatively small size of the Canadian domestic market.

Such companies would find it hard to compete on the international scene if they were subject to more onerous taxes than those which apply to their competitors." (6.9)

11. We submit that any tax which penalizes a company's shareholders penalizes the company and the tax is therefore "more onerous than those which apply to their competitors". We also submit that an internationally-oriented Canadian company has two competitors: its competitor for trade in the overseas market, and its competitor for shareholder support in the domestic market. In both instances the Canadian company with foreign operations would be carrying a burden greater than its competitors.

12. The most logical area for expansion by Canadian international companies, because of the size of the potential market, is the United States, a country in which we, as a corporation, already have a sizable commitment. Appendix A shows the lower rate of return to a Canadian investor of a dividend which comes to him from a Canadian company out of foreign source income, compared to an all-Canadian source. The return from an all-Canadian source is half again as great as from a foreign source. Even more significant, the return from a foreign source under the government's proposals is even lower than under the present tax provisions.

13. This would obviously have a negative effect on the market price of the shares of a Canadian corporation with foreign operations which, in turn, would have negative effects on that company's ability to use its stock for acquisitions and to raise capital by the issuance of new shares.

14. We urge the elimination of this discrimination and suggest that all Canadian-chartered, Canadian-based, Canadian-owned companies should be given equal integration treatment. For Canada to give full credit for foreign taxes -- instead of the 15 percent proposed -- would involve relatively minor tax revenues compared to the national advantages resulting from Canadian companies being able to aggressively exploit, without penalty, opportunities for expansion abroad.

15. If this discrimination is not eliminated, then we suggest that the very minimum concession that should be contemplated is the "streaming" of unused non-resident credits to Canadian shareholders, as discussed in the following paragraphs.

16. Canadian international companies are frequently listed on stock exchanges in the United States and consequently have United States residents as shareholders. Even those companies, such as Molson Industries, which are not listed on U. S. exchanges, have U. S. shareholders because of their operations in the U. S. Dividend tax credits accrue to U. S. shareholders in the same way as they accrue to the company's Canadian shareholders. To the U. S. shareholders, however, they are worthless.

17. Our proposal is that the Canadian company be permitted to withhold credits from shareholders who are not able to use them, e. g. U. S. residents, and to use these credits for Canadian stockholders. In other words, we propose a streaming of dividend tax credits through to the Canadian shareholders who are able to use them. This could be achieved at no greater cost to Canadian tax revenue than if all the company's shareholders and operations were in Canada. It would also make the Canadian international company as attractive an investment for Canadians as a Canadian company with all-Canadian shareholders and operations. The effect of this proposal is illustrated in the tables under Appendix B.

18. We believe this minimum concession to be vital to the welfare of Canadian companies operating internationally. In the final analysis, the return on investment to shareholders determines the course of a corporation's activities. The fact that foreign expansion under the proposed rules decreases such return on investment to a company's Canadian shareholders represents an unnecessary handicap to corporate and national growth in foreign markets.

Section D - DEFINITION OF WIDELY-HELD COMPANY

1. The White Paper establishes that a corporation once classified as a widely-held company will always remain a widely-held company. The proposal does not seem to contemplate any exception to this rule. We suggest that so rigid a definition will work undue and unintended hardships on many corporations.

2. Molson Industries Limited, for instance, owns 99.6 percent of the common stock of Anthes Imperial Limited. The listing of Anthes Imperial common stock has been withdrawn from the Toronto Stock Exchange. However, the company is listed on the Toronto Exchange for two of its three classes of preferred stock outstanding. Although this

preferred stock is of a non-voting character, the company is still classified by the White Paper as widely-held:

> "All corporations with shares listed on a prescribed Canadian stock exchange on the day the White Paper is published would be deemed to be widely-held corporations." (4.43)

3. Anthes Imperial Limited, in turn, owns all the stock of a United States corporation.

4. A problem arises in the payment of dividends from one subsidiary to another and then to the parent company. Under the White Paper proposal a dividend from the United States subsidiary to Anthes Imperial would not be taxed as it would be coming from a "controlled" corporation in a treaty country. However, when that dividend is passed up from Anthes Imperial to Molson Industries it would become subject to full corporate tax in the hands of Molson Industries, without credit for foreign corporation taxes paid.

5. We do not believe that such an inordinately severe tax result was intended, for there would be no tax application if Anthes Imperial were a wholly-owned subsidiary qualifying for partnership treatment.

6. We question the practicality of the artificial distinction made in the White Paper between closely-held and widely-held companies. We are unable to accept the rationale behind the distinction or see that it serves any useful purpose. On the contrary, we suggest that if this distinction is preserved, and forced upon the business world, it will cause only hardship and confusion.

7. If it should be the government's decision to maintain the two proposed categories of corporations, we strongly suggest:

- that companies not be precluded from moving from one category to another (e. g. widely-held to closely-held) because of their originally defined status

- that, in any event, the present exemption of inter-company dividend be retained.

Section E - DEDUCTIBILITY
OF ACQUISITION-INTEREST EXPENSE

1. While nothing is stated in the White Paper, we understand that it is the intent of the Department of Finance to propose that interest cost on debt arising out of share acquisitions be made deductible.

2. We most sincerely hope this is so, and would urge the committee's support for such a proposal. This is still one of the major inequities facing Canadian companies competing with an American company for the purchase of shares of another corporation. It is a tax inequity which has led to unnecessary loss of Canadian control of Canadian corporations.

3. Under United States tax law, a corporation is permitted, in many situations, to deduct the cost of interest on debt assumed for the purpose of acquiring the shares of another company. Such interest costs are not deductible in Canada. The result of this inequity is that a United States company can pay more for a Canadian company than a Canadian company can and still buy the company for a lower net cost.

4. There is no doubt, in our minds, that if Canadian companies were placed on an equal footing with their U. S. competitors, more of the acquisitions of Canadian companies would be made by other Canadian companies, with ownership and control remaining in this country.

Section F - CAPITAL GAINS

1. The practice of taxing capital gains is well-established in the more mature economies of the world. The inevitability of the eventual introduction of such a tax in Canada has gained general acceptance, though not necessarily endorsation or support. There are strong misgivings and apprehensions held by many leaders of the country's financial communities as to the effect of the proposed tax upon the flow and formation of capital in Canada which, as a less-mature, resource-developing country, depends heavily upon the constant availability of substantial pools of capital. We share these misgivings.

2. In particular, we believe that the enactment of the deemed realization proposals, as outlined in the White Paper, will mean eventual loss of Canadian control of many corporations brought about by the forced sale of shares to meet the tax on unrealized, but assessed, gains.

3. We suggest, also, that the unnecessary variety of proposed forms of capital gains tax will inhibit personal initiative, restrict personal enterprise and drive talented people from Canada. The capital gains proposals in the government program are unnecessarily burdensome and harassing in their requirements of the ordinary taxpayer.

4. We strongly urge the elimination from the proposals of the following:

- the five-year revaluation and arbitrary taxation of accrued, but unrealized, gains on shares of widely-held companies

- capital gains tax on proceeds from the sale of principal residences

- capital gains tax on "property held for personal use or enjoyment".

5. We recommend the following:

- inclusion of half of all capital gains which are to be taxed, regardless of source, be taken into income and taxed at personal marginal rates

- tax on capital gains not to exceed an effective rate of 25 percent on the entire gain

- if there is to be a capital gains tax, and unrealized gains are to be taxed at death, the present estate tax should be eliminated

- considerable relief be given for capital gains arising out of a wide range of corporate reorganizations, acquisitions (for stock) and mergers.

i. Five-year revaluation and Canadian control

6. The five-year revaluation and taxation of accrued gains on shares of widely-held Canadian companies is contrary to the principle of no taxation without realization, which traditionally has been, and is, the basis of capital gains taxation in other western countries, including the United States.

7. In its present form, the proposal is not a tax on income, because none is received, but a tax on the accumulation of capital. Apart from the patent inequity and injustice of the proposal, it seems to us to be extremely foolhardy when one of Canada's prime needs is risk capital -- and risk capital in large amounts.

8. The government's intent to demand payment of taxes on a gain which has not been realized and which may never be realized, will strike at the very heart of many companies which are controlled through majority shareholders who are Canadian. For many of these companies, which have grown out of original family concerns, or which have been established by a management group purchasing control, it may well mean the end of Canadian ownership. Unless these major shareholders have substantial amounts of money upon which they can draw to pay the tax on gains they have not realized, they will be forced to sell shares to pay the tax.

9. There are, obviously, few Canadians who will want to purchase a major position in a Canadian widely-held company because they will be faced with the same problem five years after their purchase. Canada, then, will have to accept a slow, but inexorable, loss of control of more Canadian corporations to foreign investors as shareholders seek funds to pay the five-year revaluation tax.

10. Had the proposed five-year revaluation tax been in force 30 years ago, Molson Industries would, at best, still be a small, regional brewing operation in the province of Quebec. It is probable it would have become part of a large U.S. brewery. It has grown into an international corporation, doing business in every province of Canada, only because the majority shareholders have been able, and willing, to plow a large part of the enterprise's earnings back into the business. Such growth, and continuation of Canadian control and direction, would not have been possible with five-year revaluation in effect.

11. The five-year revaluation proposal as it stands in the White Paper applies to corporations also. We are given to understand that it is not the government's intent to make this apply to corporations. However, we feel we should point out that if the five-year revaluation is made to apply to corporations, it would also have at least as great and irreparably damaging effects on the Canadian economy as the personal application of the proposal.

12. Many of the major Canadian financial, management or holding companies would find themselves in the same predicament as the major

shareholder of an individual corporation. Their choice of action, too, would be the same: sale to foreign interests. As a consequence, we would lose Canadian control of still more Canadian companies.

13. The United States taxes capital gains, but only after they have been realized. According to the White Paper, one effect of this is that investors with large paper profits tend to become locked-in to their investments. They are, it is said, unwilling to sell their shares because they will then be subject to substantial tax. However, we suggest that provision for tax-free reorganizations and other rollover provisions, at least as generous as those in the U. S. , could overcome any serious lock-in effect. The stock turnover on U. S. stock markets suggests that the purported lock-in effect in that country is negligible.

14. Even if the government's rationale is valid, it does not distinguish between the stock speculator whose sole objective is profit obtained by appreciation from any company's stock, and the investor whose objective is control and management of a specific company (or in the case of a holding or management corporation, several companies).

15. The possibility of obtaining additional tax revenue from a few large investors at a cost of loss of control of some of Canada's oldest and largest corporations, does not seem to us to be an exchange that is in the national interest. It would be a betrayal of the enterprise and endeavors of past Canadians and of the future of Canadians yet unborn. Such loss of control of Canadian companies to foreign interests is contrary to the stated objective of the Canadian government.

16. There are, furthermore, substantial inequities built into the five-year revaluation proposal.

17. Widely-held companies (those that have sold shares to the public) will be penalized by the five-year revaluation and possible loss of control, while competitor closely-held companies (in which a family or management group owns all the shares) will escape the quinquennial levy. This means we will have a tax situation in Canada where competitors are subject to startlingly different forms of tax treatment.

18. In addition, the White Paper proposal would almost guarantee a locked-in effect with the closely-held company concept. The shareholders of such a company would obviously have to be desperate to leave the tax shelter of their corporate structure and cause it to become a widely-held company subject to five-year revaluation. This, of course,

will limit the number of closely-held companies going public and therefore further limit the number of companies in which Canadians can invest.

19. An even more difficult situation arises in the area of international operations: a situation which affects our national integrity and honor. There are large numbers of U.S.-controlled companies operating in Canada, and they are of both White Paper categories. Some are closely-held companies; others have become widely-held in response to our federal government's urgings for foreign corporations to make shares of their Canadian subsidiaries available to Canadians.

20. If the five-year revaluation proposals are made to apply to these foreign-owned corporations, the government would be penalizing those companies which conformed to its earlier wishes and giving tax advantages to those which ignored its previous requests. This would seem to us to place the Canadian government and Canadian people in an immoral position. It would be an act which would inhibit future foreign investment in Canada and could cause the withdrawal of a substantial amount of current investment.

21. If, on the other hand, the government exempted all foreign-owned corporations from the five-year revaluation plan, it would be favoring foreign-controlled corporations over Canadian-controlled corporations. This, in turn, would undoubtedly contribute to further foreign take-overs.

22. The five-year revaluation proposal also creates an anomalous situation in a tax program designed to increase investment in Canadian companies. It could have the effect of creating just the opposite climate and make foreign investments more attractive to Canadians. While the maximum marginal Canadian personal tax rate will be 50 percent on one-half of any gain on shares of a Canadian widely-held company, the Canadian holder of foreign securities will not be affected by the five-year revaluation and will be able to control the timing of any disposition he may choose to make during his lifetime of his foreign investments. For the knowledgeable and sophisticated investor this may more than compensate for any loss of tax credit and full tax on gains, particularly when the likely effect in the marketplace may be to equate the after-tax return by inflating the price of Canadian stock.

ii. Capital gains as ordinary income

23. The government proposal to tax, in many cases, 100 percent of capital gains at marginal personal tax rates seems to us unsound and excessively high. The result can be a deterioration in the flow of capital to Canadian industry and resource development, by diminishing the average Canadian's capacity to save and invest.

24. We suggest that the soundest tax policy for any government, but particularly in our present stage of national development, for the Canadian government, is to take only those tax monies that are needed and no more. The wisdom of this can be seen in the United States where it seems to be accepted that punitive taxation leads to the abandonment of thrift and an end to enterprise.

25. Compared to Americans, Canadians are overtaxed now. If the White Paper proposals are adopted they will be even more overtaxed. The larger after-tax income of the Americans means they have more money to put into savings. These savings go to finance, directly by personal investment and indirectly through institutions, the continuing expansion and increased productivity of the United States.

26. The capital created by the savings of average Americans does not all stay in the United States. Much of the capital imported by Canada from the United States is accounted for by this vast pool of personal savings of the citizens of that country.

27. The more Canadian savings are taxed, the more dependent we become as a nation on foreign investment for our continued growth. The implications for domestic sovereignty are obvious.

28. The surest stimulus to Canadian national growth is greater scope for personal savings and a reduction in the overall tax take by all levels of government. We might add we believe that a surer and more effective way to eliminate poverty is through national growth rather than through minor tax relief.

29. Governments, by themselves, do not make the economy grow. And without a growing economy we will not eliminate poverty. A growing economy depends upon personal enterprise and an effective, dynamic, thriving private business and industry, for only a thriving business and industry creates jobs, opportunities and tax revenues. The most a government can do is to create the kind of environment which encourages -- rather than inhibits -- personal and corporate initiative, enterprise and effort.

30. We submit that the excessive taxation proposed in the White Paper does not provide that kind of climate and that its capital gains tax proposals discriminate against some sources of capital gains.

31. We offer as an alternative the proposal that half of all capital gains which are to be taxed -- no matter from what source, widely-held, closely-held or foreign corporations stocks, real estate development, etc. -- be taken into income and taxed at the personal marginal tax rate.

32. Assuming a top marginal rate of 50 percent, this would provide an effective maximum tax of 25 percent on total capital gains. It would also give those in the lower and middle incomes the benefit of lower capital gains rates, because of their lower marginal tax rates.

33. We believe this proposal would provide equity in all respects: to the source of capital gains and to the distribution of the capital gains tax burden to individual taxpayers.

34. If the decision is made to follow the present proposals of the White Paper, we believe adjustments in tax rates will be necessary in the transition period. The alternative is to have some Canadian taxpayers faced with rates that are almost confiscatory.

35. The White Paper proposes to reduce the present high marginal rates of personal income tax to a maximum rate of approximately 50 percent over a five-year period after implementation day. Accordingly, in the first year following implementation day, the top rate of tax, on the basis of a 28 percent provincial tax, will still be 81.92 percent. If capital gains, accrued after valuation day and realized during the transition period, are taxed at full rates, the cost of realization for some taxpayers would be prohibitive.

36. In the interest of equity, it is therefore suggested that during the transition period a maximum separate marginal rate not exceeding 25 percent be established for capital gains. This rate would hold until the proposed maximum 50 percent marginal rate on ordinary income is established.

iii. Personal residences

37. It is very doubtful if any government can benefit by levying nuisance taxes or taxes which cost more to administer than they raise in revenue. The proposals to levy capital gains taxes on the proceeds of the

sale of personal principal residences and personal assets in excess of $500 value would, by all reasonable standards, fall into both categories.

38. After indicating that capital gains would be levied against the sale of principal residences the White Paper notes: "Generally, capital gains on the sale of homes would not be taxed". A reasonable question is then: Why bother? We suspect the answer is that the government is as aware as anyone else, that its proposal to permit a total tax deduction of $1,150 (including $150 for improvements) a year of occupancy would not, for most Canadian home owners, keep up with the inflationary loss of purchasing power of the Canadian dollar. If inflation in recent years is accepted at the rate of four percent per year then owners of all houses with an original purchase price of $25,000 or more would be paying capital gains tax on inflation.

39. In 1969, the average price of all houses sold in Metropolitan Toronto was $29,000. This annual average price has increased at an average rate of $2,500 a year since 1965. There is no indication that such averages will be lower in the future, and every indication they will be higher.

40. In view of the fact that a house is usually the only asset of real consequence owned by most people, and the proposal seems to be aimed at taxing the large speculator rather than the small houseowner, we urge:

- the elimination of the proposal, as at best it will be only a minimal revenue producer; <u>or</u>

- adoption of the U.S. system of deferred taxation; <u>or</u>

- a meaningful deduction, that covers inflation and improvement cost, of <u>at least</u> five percent of original purchase price per year of occupancy.

41. We strongly urge the elimination of the proposal, as we believe there is an easily discernible difference between property held for gain -- either speculative or investment -- and the average taxpayer's home. We feel sure the government can devise legislation that will enable it to tax capital gains revenue from large speculators without harassing every Canadian home owner.

iv. Effect of deemed realization on employee transfers

42. We must assume that the proposals to tax "property held for personal use or enjoyment" and, in particular, the application of deemed realization on leaving Canada, were constructed with only limited knowledge of the number of annual movements of personnel across the Canadian-United States border by international companies in both countries.

43. It is disturbing to see introduced into a climate of expanding international movements of business personnel, proposals that will undoubtedly inhibit the transfer of Canadians to the U. S. and Americans to Canada, in standard management training programs.

44. A number of our employees are citizens of the United States and these proposals would discourage them from accepting transfers into Canada. The proposals could also lead to capital gains tax complications between Canada and the United States.

45. These proposals would force a Canadian, giving up Canadian residence to work (usually on a temporary or limited timespan basis) in another country for his employer, to pay capital gains tax because he will be deemed to have "sold all his assets on that day at their fair market value". The same taxing policy, of course, would apply to an American returning to the United States after being thus employed in Canada. We consider this proposal impractical, in the light of contemporary business practice.

46. This proposed tax treatment would also seem to be another area in which the government is aiming its sights at the very wealthy who can afford to "invest" in fine arts, jewelry and rare stamps and coins and is attempting to apply the tax to all Canadians. The result would be to wrap all Canadians in an excess of forms, paper and bureaucracy, while the ensuing tax revenue will probably be negligible.

47. The White Paper is correct when it recognizes that to defend themselves against arbitrary assessment of capital gains tax, Canadians "would have to become a nation of bookkeepers". While the large investor in jewelry, paintings and individual rare stamps and coins, would not have to maintain any significant amount of record keeping, the small lifetime average Canadian hobbyist stamp or coin collector would have to maintain absolute records of every stamp and coin bought, sold or traded to protect himself from future arbitrary declarations of increase in value.

48. Because there is so little revenue involved, because of the impracticality of maintaining international business transfers and to prevent Canadians from becoming a nation of bookkeepers, we seek the committee's support for the elimination of this proposal.

Section G - DEDUCTIBILITY OF ENTERTAINMENT AND CONVENTION EXPENSES

1. The White Paper leaves the implication that the government believes there is widespread abuse of the provisions in the current Income Tax Act covering entertainment expenses. It proposes to "deny deduction for entertainment expenses, the costs of attending or sending employees to conventions".

2. There is, to the best of our knowledge, no evidence that there is such tax abuse on a widespread scale and we suggest present legislation provides adequate and meaningful safeguards against possible abuse.

3. Such a denial of expenses, that are reasonable and necessary for business purposes, will penalize Canadian companies in three ways:

- by placing them at a competitive disadvantage with United States companies

- by reducing the amount of money available for the improvement of management, professional and supervisory skills through seminars and conventions

- by dictating how they can, or should, spend their sales promotion dollars.

4. The first point does not really require elaboration. It is obvious that U. S. companies seeking business in Canada will have an advantage over Canadian companies if their sales-promotion-entertainment expenses are deductible and those of the Canadian company are not. The same competitive advantage will accrue to U. S. companies in that country when competing against Canadian companies seeking business in the United States.

5. This seems to be an impractical and unnecessary handicap for the Canadian government to wish to hand to Canadian companies. It is one that can only work to the advantage of companies who do not pay tax to

Canada. It, too, can only reduce corporate income tax by reducing corporate sales.

6. As is the practice of many corporations, it is the practice of Molson Industries to provide its employees, from time to time, with the opportunity to attend conventions and seminars to increase their knowledge, improve their skills and consequently their contribution to the corporation. These conventions and seminars are usually sponsored by recognized professional or business organizations and universities. We consider them an effective method of education.

7. It must be obvious that if these expenses are going to cost Canadian companies twice as much as they have in the past, some activities will have to be curtailed. This can only be done at the risk of loss of business and a reduction in the amount of skills improvement the average company will be able to provide its employees.

8. By dictating thefashion in which companies can or should spend their sales promotion dollars, the proposal discriminates against some companies. General consumer-oriented companies can simply turn their client entertainment dollars into additional advertising and probably maintain their share of market. Corporations which sell in restricted or narrow markets, and which depend upon personal contacts and a high degree of personal selling, cannot effectively do this and will therefore be penalized.

9. We believe the proposal to be capricious, unrelated to commercial realities and injurious to Canadian business. Tax considerations should not be permitted to discriminate against one class of business in favor of another. We strongly urge the rejection of this proposal.

Section H - INCENTIVE VALUE OF STOCK OPTIONS

1. The competitive posture of Canadian companies, in their attempts to recruit and retain talented Canadians and Americans against the competition of American companies, is affected as much by the non-salary rewards they are able to offer as it is by salaries.

2. We are, therefore, disappointed that the White Paper did not recognize the role that stock options can play in professional and management incentive programs.

3. In fact, this lack of recognition permits the capital gains tax proposals to further reduce the effectiveness of programs that were already reduced in value by the 1966 amendments to the Income Tax Act. At that time, the 20 percent tax credit on benefits from stock options was reduced to $200. This amendment removed substantially all of the incentive inherent in stock option programs.

4. The White Paper leaves stock options open to tax at two points in time: at time of assumption of the option and at time of sale of the stock.

5. In the interests of permitting Canadian companies to remain competitive in recruiting talented people, we urge that Canadian tax law be amended to provide that benefits accruing under stock option plans be taxed on a basis no less favorable than similar benefits under U. S. tax legislation.

Section I - EFFECT OF HIGHER PERSONAL CANADIAN TAX RATES

1. The loss of many of its talented people to other -- apparently more attractive -- economies, particularly that of the United States, has always been a major problem for Canada. These Canadians have left for many reasons. The majority, however, emigrated to the United States because they believed there was greater opportunity for advancement in the larger economy, because the pay for the same job was usually higher, and because the lower U. S. tax rates made their take-home pay even greater. In fact, most found they could earn more money in the United States and still pay less taxes than they had paid in Canada on a much lower salary.

2. Canada's problem of retaining its talented people and attracting talented people from other countries was acknowledged by the White Paper. It said: "Canada needs the full effort of those with outstanding ability. It must compete for such people with other countries where all Canadians can go to live and to work if they wish." (2. 39)

3. Having acknowledged the problem, the White Paper then proceeds to make the problem even greater.

4. Canadians, relative to their American neighbors, already pay more taxes. The implementation of the White Paper proposals will widen

the gap as American taxes decline with the reduction, and then elimination, of the 10 percent surcharge, while Canadian rates, on middle income brackets, are raised. The additional burden of the proposed capital gains tax will increase the disparity. It may also increase the possibility of loss of talented people as, for many enterprising management and professional people, the absence of a capital gains tax in Canada has been compensation for higher income taxes.

5. The initial material released with the White Paper indicated that the new Canadian personal income taxes compared favorably with those in the United States.

6. As a corporation with employees in both countries, we suggest that the material simply does not present an accurate picture of the true state of affairs. There does not seem to be proper recognition of the effect of the U.S. deductions on the income tax returns of middle-income residents in the United States.

7. The difference, under the White Paper proposal, between U.S. and Canadian personal income tax rates, is so significantly large that taxation of itself could become a major consideration in the decision of management and professional people to remain in Canada or emigrate. To put it another way. When middle-income Canadians with family responsibilities find the price, in income taxes, for living in Canada is not just 20 percent, 30 percent or even 50 percent, but could be more than 100 percent higher, than living in the United States, they may very well ask themselves seriously if the price of remaining in Canada is not getting too high.

8. Higher pay and lower taxes are not the only economic lures enticing talented Canadians to the United States. They are also attracted by the higher value of United States currency in domestic purchasing power, created by the greater productivity of the American economy.

9. A further widening of the already too-wide gap between the U.S. and Canadian income tax structures will not only increase Canadian industry's problem of competing against the U.S. companies for its indigenous talent. It will also increase, if not make almost impossible, the task of recruiting talented young Americans to work in, and with, Canadian-based international companies, such as Molson Industries.

10. The pat and obvious answer of increasing salaries is simply no answer at all. It would increase corporate costs, weaken Canada's competitive position in world trade and contribute further to domestic inflation.

11. The long-term solution, of course, is an increase in Canadian national productivity. Until we are able to achieve this, we submit that every effort must be made to reduce our personal tax levels to the point where they become internationally competitive.

Section J - INFLATIONARY IMPACT OF WHITE PAPER PROPOSALS

1. Molson Industries has endorsed and supported, as a corporation and as an active member of professional and trade associations, the government's attempt to stem inflation.

2. It is confusing, therefore, to be faced with a series of tax proposals which have been described by some of the country's leading financial and tax authorities as highly inflationary. It is hard to quarrel with such a description.

3. Full implementation of the White Paper proposals will, in the fifth year, yield $630 million in new revenues and extend $1. 5 billion in tax relief, most of it in lower income brackets, for a total of $2. 13 billion in new taxes and higher rates for existing taxes. This $2. 13 billion, in new and higher taxes, will be levied against people in the middle and upper-income brackets and against corporations.

4. If the Ontario government's estimate of the yield of the proposed new tax structure is correct, then one must add another $650 million to the total. We are then faced with an awesome total of $2. 78 billion in new and higher taxes being levied against the segments of society which, to date, have provided the bulk of the savings and capital for the national development.

5. The proposed new and higher taxes would, in effect, bring about a massive shift -- either $2. 13 billion of $2. 78 billion -- from the class of taxpayers who provide the bulk of savings and capital to others who will provide the greatest consumer demand. Such a transfer would almost certainly be inflationary.

6. The White Paper proposals are not only likely to add to the fuels of inflation by the move of so much money from savings to consumption, but also by the psychology it is likely to generate. Inasmuch as the proposals strike at the philosophy of thrift, many who might have otherwise put aside some part of their remaining income in savings and investment will be left with little or no inducement to do so. They will have instead -- by government example and policy -- every inducement to spend. They will thus add to the demand pressures on our economy.

7. The inflationary nature of such a large monetary shift raises three important questions:

- why were tax increases introduced into a White Paper that was purportedly directed towards reform of the tax structure?

- how much in tax revenue will really be raised by the White Paper proposals?

- what does the federal government plan to do with the increased tax revenues?

8. The introduction of proposals to bring about tax reform which, in fact, would result also in substantially increased tax revenues is difficult to accept. We submit that before there can be acceptance of such proposals that would increase the tax burden, the government has a responsibility to identify the need for increased revenue.

9. At the time this submission was being prepared there had been no reconciliation of the enormous disparity in estimates by Ontario and federal government officials, nor had there been any publication of the fundamental information and basic assumptions on which these two estimates rest.

10. It is possible that neither the federal government nor the Ontario government is correct. However, this is cold comfort for the Canadian taxpayer who is being asked to make judgments on tax proposals that will affect the future development of Canada and his personal welfare.

11. There is no indication in the White Paper, nor has there been in the comments made by government spokesmen, that there has been any forecasting or planning of future federal fiscal needs. There is no indication in the White Paper, or subsequent government publications, of

adequate studies of the impact of the White Paper proposals on the economy, on consumer spending, on savings and investments, or the flow of capital in and out of the country.

12. Rather than increasing the inflationary pressures by increased taxation, this is the time for the federal government to hold the line on expenditures and permit the proposed new tax revenues to flow instead into savings and investments needed to further the growth of the Canadian economy.

13. A federal government approach, dedicated to controlled cost and expenditures, could permit a lower rate of capital gains tax than is proposed and a reduction of personal income taxes instead of the increase in such taxes proposed by the White Paper.

Section K - NEED FOR COORDINATED FEDERAL/PROVINCIAL/MUNICIPAL TAX PLANNING

1. To undertake national fiscal planning on the basis of "senior" and "junior" governments is to ignore the demographic and financial realities of the nation and the 20th century. When we have "urban provinces" or "city states" of the size of Montreal and Toronto, it would be foolhardy for the federal government to arbitrarily attempt to carry out meaningful tax reform without partnership participation of the provinces and the municipalities.

2. We are becoming an urban nation and we must accept that fact. We must establish our financial house to anticipate and handle the fiscal problems of such a society. We have the example, in many major United States cities, of what can happen to our society if we do not.

3. The company, its employees and its shareholders, as with all Canadians, pay taxes to at least three levels of government. Because of these uncoordinated levels of taxation, and the overlapping tax jurisdictions in Canada, the true level of the amount of Canadian income that is going into taxes is not well recognized on a corporate or individual basis. This total level of individual taxation is unrealistically high when compared with that of the United States.

4. Molson Industries does business in all 10 provinces and has production facilities in seven of them. It is, therefore, well acquainted with the many levels of taxation in Canada. In its 1969 fiscal year, for example, the company paid:

- $12.2 millions in income taxes to the federal government and 9 provincial governments

- $3.7 millions in municipal taxes to 39 cities, towns and municipalities across Canada

- $76.7 millions in excise and sales taxes to the federal government and 9 provincial governments.

5. Out of a total sales revenue of $295.6 million, the company's total tax contribution in Canada was $92.6 millions.

6. In contrast, the company in 1969:

- had net (after tax) earnings of $15 millions

- paid salaries and wages of $46.2 millions.

7. From the $46.2 millions paid in wages and salaries, the company withheld and paid $7.7 millions in personal income taxes of its employees.

8. In addition to the taxes it paid in Canada, the company also paid taxes to foreign federal and state governments and municipalities in which it does business.

9. In view of the rising fiscal needs of the provinces and municipalities -- which can only be met by increased taxation -- we are, frankly, alarmed at the fact that the federal government, in its White Paper, has reserved the major part of any increase in taxes for itself. We find this hard to justify when the recent federal-provincial conference indicated that the greatest tax deficits and needs, for the foreseeable future, are in the provincial-municipal areas. This same conference indicated that, by 1971, the provinces and municipalities would account for approximately 63 percent of all public expenditures in Canada.

10. We submit that the Canadian taxpayer, whether corporate or individual, has a right to expect that the needs and requirements of all levels of government will be included in any real national program of tax reform. We further submit that "tax reform" will be a meaningless political catch phrase until such government coordination in taxation is achieved.

Appendix A
(Adapted from tables originally prepared by CCH Canadian Ltd.)

	Dividend From a Controlled Foreign Corporation in a Treaty Country			Dividend From WHC	
	Dividend Routed Through Canadian Corporation - Present Treatment	Dividend Routed Through Canadian Widely-held Corporation - Proposed	Dividend Routed Through Canadian Closely-held Corporation - Proposed	Dividend Routed Through Canadian Widely-held Corporation - Proposed	Dividend Paid Directly-Present & Proposed
Foreign Corporation					
Dividend paid	$ 1,000	$ 1,000	$ 1,000		$ 1,000
Foreign withholding tax	150	150	150		150
Canadian Corporation					
Net dividend received	850	850	850	$ 1,000	
Dividend "declared"	850	1,000	1,000	1,000	
Less: Foreign creditable tax "deducted"	-	150	150	-	
Individual					
Net dividend received	850	850	850	1,000	850
Gross-up for foreign tax: 15/85 of net dividend received limited to foreign creditable tax of payer	-	150	150	-	150
Gross-up for Canadian tax				500	
Taxable Income	850	1,000	1,000	1,500	1,000
Tax at 40%	340	400	400	600	400
Tax credit	170	150	150	500	150
Net tax	170	250	250	100	250
Net dividend retained	$ 680	$ 600	$ 600	$ 900	$ 600

Assume parent has 10% of its income from Canadian operations & 90% of its income from foreign subsidiaries operating in treaty countries.
Assume subsidiaries distribute 50% of net income and parent distributes approximately 50% of consolidated net income.

	Gross Income	Net Income	Creditable Tax
Pre-tax income from Canadian operations	$100,000		
Less Canadian tax	50,000		$25,000
		$50,000	
Pre-tax income from foreign subsidiaries	900,000		
Less foreign corporation tax	450,000		
	450,000		
Less earnings retained in foreign subsidiaries	225,000		
Dividends paid by foreign subsidiaries	225,000		
Foreign withholding tax at 15%	34,000		34,000
		191,000	
Net income available for distribution		241,000	
Add retained earnings of subsidiaries		225,000	
Consolidated net income		$466,000	
Dividends paid		$232,000	
Available tax credit			$59,000
Tax credits under White Paper proposals:			
on first - gross up at 50%		$ 78,000	$39,000
on next - gross up at 15/85th		113,000	20,000
on next - no gross up		41,000	-
		$232,000	$59,000

Appendix B - Schedule 1
Page 1 of 2

Assume 25% of shares held by Canadians and 75% held by non-residents.

	Canadians	Non-Residents	Total
Net dividends	$58,000	$174,000	$232,000
Gross-up for creditable foreign tax (CFT)	8,500	25,500	34,000
Gross dividend	66,500	199,500	266,000
Gross-up for creditable Canadian tax (CCT)	6,250	18,750	25,000
Grossed up dividend	72,750		
Assume 40% rate for Canadians:			
Tax	29,100	* 29,925	59,025
Less credit	14,750	25,500	40,250
Net Canadian tax	14,350	4,425	18,775

*15% of $199,500

If in above example all the CCT had been available to Canadian shareholders & the CFT primarily for non-residents, the result would be:

	Canadians	Non-Residents	Total
Net dividends	$58,000	$174,000	$232,000
Gross-up for CFT	3,000	31,000	34,000
Gross dividend	61,000	205,000	266,000
Gross-up for CCT	25,000		25,000
Grossed up dividend	$86,000		
Assume 40% rate for Canadians			
Tax	$34,400	ɸ$ 31,000	$ 65,400
Less credit	28,000	31,000	59,000
Net Canadian tax	$ 6,400	-	$ 6,400

ɸ 15% of $205,000

Schedule 1
Page 2 of 2

Assume parent has 50% of its income from Canadian operations and 50% of its income from foreign subsidiaries operating in treaty countries.

Assume subsidiaries distribute 80% of net income and parent distributes approximately 80% of consolidated net income.

	Gross Income	Net Income	Creditable Tax
Pre-tax income from Canadian operations	$500,000		
less Canadian tax	250,000		$125,000
		$250,000	
Pre-tax income of foreign subsidiaries	500,000		
less foreign corporate tax	250,000		
	250,000		
less earnings retained by subsidiaries	50,000		
Dividends paid by foreign subsidiaries	200,000		
Foreign withholding tax at 15%	30,000		30,000
		170,000	
Net income available for distribution		420,000	
Add subsidiaries' retained earnings		50,000	
Consolidated net income		$470,000	
Dividends paid		$376,000	
Available tax credits			$155,000

Tax credits under White Paper proposals:

	Net Income	Creditable Tax
On first - gross up at 50%	$310,000	$155,000
On next - no gross up	66,000	-
	$376,000	$155,000

Schedule 2
Page 1 of 2

Assume 50% of shares are held by Canadian residents and 50% held by non-residents.

	Canadians	Non-Residents	Total
Net Dividends	$188,000	$188,000	$376,000
Gross-up for creditable foreign tax (CFT)	15,000	15,000	30,000
Gross dividend	203,000	203,000	406,000
Gross-up for creditable Canadian tax (CCT)	62,500	62,500	125,000
Grossed up dividend	265,500		
Assume 40% rate for Canadians:			
Tax	106,200	* 30,450	136,650
Less credit	77,500	15,000	92,500
Net Canadian tax	28,700	15,450	44,150

*15% of $203,000

If in the above example all the CCT had been available to Canadian shareholders and the CFT primarily for non-residents, the result would be:

	Canadians	Non-Residents	Total
Net dividends	$188,000	$188,000	$376,000
Gross-up for CFT	-	30,000	30,000
Gross dividend	188,000	218,000	406,000
Gross-up for CCT	94,000	-	94,000
Grossed up dividend	282,000		
Assume 40% rate for Canadians:			
Tax	$112,800	ϕ$ 32,700	$145,500
Less credit	94,000	30,000	124,000
Net Canadian tax	$ 18,800	$ 2,700	$ 21,500

ϕ 15% of $218,000

Schedule 2
Page 2 of 2

APPENDIX "B"

UNION CARBIDE CANADA LIMITED

COMMENTS ON
THE PROPOSALS FOR TAX REFORM

Union Carbide Canada Limited fully supports the Brief that has been filed by the Canadian Chemical Producers' Association. In this connection, we wish to make the following additional comments.

INTEGRATION PROPOSAL

We are opposed to the proposal to integrate personal and corporation taxes for the following reasons:

1. It would not be possible, because of the 2-1/2 year time limit for payment, to pass to Canadian shareholders all of the tax credit for a taxation year to which they would be entitled unless cash and/or stock dividends equalled 100% of after-tax earnings. It certainly is not possible for a public Company to pay 100% cash dividends and stock dividends would, on a regular basis, present many complications and would probably not be acceptable to Managements of large Canadian public Companies. Also, stock dividends would probably not be acceptable to Canadian shareholders whose marginal rate exceeds 33-1/3% since tax would be payable. Since Canadian shareholders would not want to lose any of the tax credit, we believe there would be great pressure on Managements of listed Canadian Companies to increase dividend payouts. It is noted that closely-held Companies, e.g. those 100% foreign owned would not have this problem with the net result that within the chemical industry those Companies with some of their stock available to Canadians would be at a disadvantage compared to those Companies 100% foreign owned.

cont'd

As a very minimum, we believe the 2-1/2 year payment rule should be eliminated and that there should be no time limit for passing on tax credit to Canadian shareholders.

2. At the present time, dividends received by a Canadian corporation from another tax-paying Canadian corporation are received free of tax; a highly desirable situation since double taxation is avoided. Under the proposal, such dividends would now be taxed except that the receiving corporation would receive credit for tax paid by the paying corporation. In those cases where the paying corporation had not paid sufficient tax to cover the dividend, e.g. by reason of high capital cost allowances, the receiving corporation would have to pay tax on the dividend resulting in double taxation. The integration proposal destroys at the shareholder level the capital cost allowances and other incentives provided at the corporate level.

We are also concerned regarding the position of Canadian subsidiaries and affiliates of Canadian companies. It will be necessary, in some manner, to value the shares of such subsidiaries and affiliates on valuation day for capital gains purposes. However, we understand that such share value will then be compared to the net book value of the subsidiary or affiliate and that all dividends subsequently paid by the Company will be taxable in the hands of the parent Company until such time as dividends paid have equalled the difference between share value and book value of the Company on valuation day. Since the "difference" represents goodwill that was built up before valuation day, the above method of treatment clearly imposes a capital gains tax on a retroactive basis.

We believe that the present arrangement permitting tax-free receipt of Canadian inter-corporate dividends should be continued to avoid double taxation of corporate income.

3. The proposal would treat Canadian shareholders more favourably than foreign shareholders. We feel that pressures will mount to extend the same treatment to foreign shareholders which would be detrimental to Canada.

4. The integration proposal is complicated and cumbersome and results in the bad effects noted above. It is a radically different system compared to present tax law and may well result in negative effects not presently foreseeable.

5. We believe that it is desirable to offer further incentives to Canadian shareholders to invest in Canadian Companies. However, we feel that this objective can be accomplished to the same degree as proposed in the White Paper by expanding and revising the present dividend tax credit system which is simple, workable and easily understood. This could be done by varying the dividend tax credit rate according to the marginal tax rate of the individual shareholder and permitting refunds of tax where such are indicated. Such an expansion of the dividend tax credit system would result in the advantages to the Canadian individual shareholder associated with integration and would avoid the important disadvantages to which we have referred.

EXPLORATION EXPENSES

We note with approval the provisions proposed in the White Paper concerning exploration and development costs - Paragraph 5.26. At the present time taxpayers whose principal business is not mining, the production of oil or certain allied activities may only deduct such expenses against income from

mineral properties. Under the proposal, a taxpayer would be entitled to set up exploration expenses in an asset class and claim an annual write-off for tax purposes equal to 20% of the net book value of the class. This welcome change in exploration expense handling will enable taxpayers whose main business is not in the resource industries to participate more fully in the exploration field.

APPENDIX "C"

NATIONAL SEA PRODUCTS LIMITED

SUBMISSION

TO

THE SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

CONCERNING

THE WHITE PAPER PROPOSALS

FOR

TAX REFORM

NATIONAL SEA PRODUCTS LIMITED

NATIONAL'S BUSINESS AND OPERATIONS:

National Sea Products Limited (National) carries on the business of catching, processing and marketing fish products.

This Company owns 42 deep sea trawlers of which 24 have been brought into service since 1960. Processing operations are carried on in 16 processing plants, 9 of which are engaged in processing ground fish, other fish and scallops, 5 in the processing of lobsters and 2 in the manufacture of herring meal and oil. Seven of these plants are located in Nova Scotia, 4 in New Brunswick and 1 each in Prince Edward Island, Quebec and Newfoundland. In addition, subsidiaries of National operate a fish processing and cooked fish plant in Rockland, Maine and a shrimp processing plant in Tampa, Florida.

These processing operations in Canada include filleting and preparation of fish for marketing as fresh, frozen, smoked and cooked fish products. National also processes in Canada fresh lobsters, frozen lobsters in the shell, frozen lobster meat, canned lobster, frozen shrimp and crab meat. Waste from filleting operations, amounting to approximately 2/3's of the landed weight, is reduced by further processing to fish meal and other valuable end-products which have become an increasing important part of operations. In 1969 the

Company completed construction of its first herring reduction plant in Shippigan, New Brunswick and in 1970 a subsidiary of the Company opened a new herring reduction plant in Burgeo, Newfoundland.

In the year ended August 31, 1969 gross fish landings at the Company's processing plants were 284,000,000 pounds and sales for the same period were $62,000,000.00.

Sales and distribution of products are handled from sales offices and warehouses in Halifax, Montreal and Toronto, from sales offices in Edmonton, Rockland and Tampa and through regional distributors and agents across Canada and the United States.

The fishing industry is labour intensive. National's processing operations employ approximately 2,100 full time plant personnel and during peak periods employment runs as high as 4,100 persons. There are also approximately 150 full time office and sales personnel. Approximately 2,600 fishermen (including the 600 sharesmen who man the Company's Trawlers) sell their fish to National.

National's shares are listed on the Montreal Stock Exchange and it is a widely-held corporation as that term is defined in the White Paper. It has approximately 1,100 common shareholders and approximately 500 preference shareholders. Eighty percent of all shareholders reside in the Atlantic Provinces.

EFFECT OF PROPOSED TAX INTEGRATION ON INVESTMENT IN NATIONAL'S SHARES:

Over the past six years the Company has been

engaged in an extensive expansion program. During this period it has invested in excess of $22,000,000 in vessels, plant and equipment. These funds came from three sources, namely:

(a) borrowings secured by bonds, debentures and mortgages;

(b) sale of common and preference shares;

(c) cash flow.

Cash flow is a most important source of capital funds. A large part of National's cash flow is represented by income taxes which have been deferred as a result of claiming capital cost allowances. In addition to claiming the regular capital cost allowances provided under the Income Tax Act, National has claimed in respect of some of its fixed assets the accelerated capital cost allowances permitted under incentive legislation. Two examples of capital cost allowances available to National under incentive legislation are as follows:

1. National is permitted to claim under the Income Tax Act and the Canadian Vessel Construction Assistance Act capital cost allowance on the net after subsidy cost of its trawlers at the rate of 33 1/3% per year on a straight line basis;

2. In 1969 National constructed a herring reduction plant at Shippigan, New Brunswick at a cost of approximately $2,250,000. Shippigan is within a designated area under the Area Development Incentives Act. As a result the Company was entitled,

(a) to a non-taxable incentive grant in respect of the cost of the new plant. This grant did not reduce capital cost for allowance purposes; and

(b) to claim capital cost allowance on equipment at the rate of 50% per year and on buildings at the rate of 20% per year both on a straight line basis.

If it were not for the cash flow resulting from claiming capital cost allowance, the Company would have been unable to expand at the rapid pace indicated above. The Company had planned to continue this policy of expansion.

A second important source of funds to the Company is share capital. While the recent expansion of the Company has been financed largely by borrowings and cash flow share capital has also been invested. If the Company is to continue to expand, it must seek from its existing shareholders and the public large amounts of share capital in the next few years. It is in this context that the White Paper Proposals are of greatest concern to the Company.

Paragraph 1.10 of the White Paper reads as follows:

> "1.10 The second main objective of tax reform is to see that the tax system does not interfere seriously with economic growth and productivity. Taxes by their nature cannot always promote all our economic goals, but they should interfere as little as possible with incentives to work and invest and with the directions our economy follows in meeting demands of consumers and foreign markets. Some proposals in this paper are intended to ensure that the incentive to work and invest is not unduly inhibited and that investments needed for productivity and public purposes are not rejected in favour of less desirable alternatives just because of their tax consequences."

While the Company is in complete accord with this objective, it respectfully submits that the objective is not realized by the specific proposals put forward. National submits that the proposals relating to dividend tax credits tend to "interfere seriously with economic growth" by favouring investment in mature companies that do not require new equity capital and by discouraging investment in growing companies that do need new equity capital.

Under present income tax legislation a shareholder of a Canadian corporation receives a 20% dividend tax credit whether or not the paying corporation pays substantial tax, little tax or no tax at all. Consequently, an expanding company such as National can presently,

(a) defer income taxes by claiming capital cost allowances;

(b) apply the cash resulting from this tax deferment to the purchase of vessels, plant and equipment; and

(c) seek new equity capital knowing that the purchasers of its shares will receive the same dividend tax credit as those of other Canadian corporations.

While no change in (a) or (b) is proposed, the White Paper provides that the dividend tax credit to which a shareholder is entitled will be based on the amount of tax paid by the dividend paying corporation.

This proposal, if implemented, would result in very different tax treatment between the shareholders of

(a) Companies which do not require a large invest-

ment in depreciable assets relative to their earnings or which have paid for their depreciable assets in prior years by claiming capital cost allowances. (For the purpose of convenience companies which fall into this category are referred to in this brief as "mature companies"); and

(b) Expanding companies such as National which are investing annually large amounts of money relative to their earnings in depreciable assets. (Again for the purpose of convenience, companies which fall into this category are referred to in this brief as "expanding companies").

The difference is that most of the cash flow of the mature company is subject to tax in the year in which it is received and on the payment of dividends one-half of this tax may be treated by shareholders as a dividend tax credit. By claiming capital cost allowances the expanding company can defer payment of much or all of the taxes otherwise payable until a later year. As the expanding company has not paid any substantial tax relative to its cash flow there is little or no creditable tax that can be passed on to its shareholders in the form of a dividend tax credit.

In 1968 and 1969 as a result of claiming capital cost allowances National did not pay any income taxes. That is, it deferred the payment of tax until a later year when its capital cost allowances will be diminished or exhausted. Had the White Paper Proposal been in effect in 1968 and 1969 the shareholders of National would not have been entitled to any dividend tax credit in respect of dividends received.

This difference in tax treatment of shareholders of mature companies compared with shareholders of expanding companies such as National is illustrated on Schedule A. From this schedule it can be seen that the taxpayer with a 50% marginal tax rate who owns shares of a widely-held mature company will retain (after the payment of tax) $75 of each $100 dividend. The same shareholder with a 33% marginal tax rate will retain (after the payment of tax) $100 of each $100 dividend. National's shareholders with corresponding marginal tax rates will retain only $50 and $70 respectively out of each $100 dividend received.

There may be some logic in permitting a dividend tax credit to a shareholder only to the extent that the paying corporation has paid tax. But logical or not, such a policy, if implemented, will seriously interfere with economic growth in Canada and particularly with economic growth in the Atlantic Region. This becomes apparent on considering the ability of an expanding company to raise share capital.

The first requisite of economic growth is the willingness of an investor to invest capital. As pointed out above, National can continue to expand at its present rate only if it can attract large amounts of new share capital.

As shareholders of all Canadian companies are treated equally under present tax legislation National does not suffer any disadvantage merely because it is an expanding company. However, under the White Paper Proposals National will be at a considerable disadvantage in raising share capital compared

with the mature company, whose shareholders will be entitled to a substantial tax credit. Obviously, the potential investor will prefer to invest in the shares of the mature company rather than in those of the expanding company.

The anomalous result is that the White Paper Proposals induce Canadians to invest in the shares of mature companies which do not need new share capital and discourages the investment in expanding companies which do need share capital. It will encourage Canadians to trade on the stock market in the shares of mature companies but will discourage the purchase of new issues of expanding companies. To use the words of paragraph 1.10 of the White Paper "investments needed for productivity...(will be)...rejected in favour of less desirable alternatives just because of their tax consequences."

While this result will most certainly interfere with economic growth in Canada as a whole, its impact will be greater in the Atlantic Provinces and other slow growth areas than elsewhere. This is so principally for two reasons:

1. All levels of government recognize the need for massive capital investment in the Atlantic Region if its economic expansion is to keep pace with the rest of Canada. By discouraging capital investment in expanding businesses, the White Paper discourages the growth of the area;

2. Federal legislation has encouraged economic growth in the Atlantic Region by permitting accelerated depreciation of new capital assets such as fishing vessels, production equipment and plant. National and its shareholders have been induced by these incentives to invest large amounts

of capital in the Atlantic Provinces. If the economic advantages of these inducements can no longer be passed on to the shareholder, then the inducements lose most of their attraction. Indeed from the prospective shareholders point of view this kind of legislation when coupled with the White Paper Proposals creates little or no incentive to invest in a company such as National whose principal assets are located in the Atlantic Region.

This portion of the Company's brief can be summarized as follows:

(a) The Company supports the White Paper objective of seeing that the tax system does not interfere seriously with economic growth;

(b) The specific White Paper Proposals concerning dividend tax credits run counter to this objective;

(c) The proposals, if implemented, would encourage trading on the stock market in the shares of mature companies. It would impair the ability of expanding companies to sell new issues of shares;

(d) The proposals hit hardest at slow growth areas such as the Atlantic Region which require massive injections of capital (including share capital) by reducing the effectiveness of Canada's incentive policy of permitting accelerated capital cost allowances on investment in new vessels, production equipment and plant.

TAX ON UNREALIZED CAPITAL GAINS:

The White Paper also proposes a capital gains tax. In proposing this tax, a distinction is made between closely-

held corporations and widely-held corporations. As the shares of National are listed on a Canadian stock exchange, it is considered by the White Paper to be a widely-held corporation. It is proposed that a shareholder of a widely-held corporation will include in taxable income one-half of the gain on the sale of his shares. If the shareholder retains his shares, he will be required to revalue them every five years and to include in taxable income one-half of the resulting appreciation.

This distinction in tax treatment between the shareholders of closely-held and widely-held corporations is justified by the White Paper as follows:

> "Periodic revaluation would reduce somewhat the value of the half-gains rule. It would reflect the fact that these shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily at the time of his choosing. The shares of private companies do not have the same marketability."

A number of persons engaged in the management of National own large blocks of its common shares. They have no desire to sell these. The investment by managers in their employers shares is generally regarded as a healthy incentive. National so regards it. In spite of this the White Paper Proposals, if implemented, would place financial pressure on the shareholders to sell a portion of their shares every five years in order to pay taxes on profits that have not been realized.

It is respectfully submitted that such action is grossly unfair to these shareholders. It is also unfair to National as it impairs the incentive which exists when a manager is a substantial investor in the company that employs him.

More than 90% of the outstanding common shares of National are owned by Canadian residents. It is submitted that the pressures on holders of large blocks of shares to sell portions of their holdings will stimulate the takeover of many companies by foreign interests. Schedule B illustrates the effect of taxing unrealized gains and the resulting disposition of shares to pay that tax.

Over the past few years several United States companies have expressed an interest in acquiring control of National. However, the shareholders of National wish to retain their investment in this Company and all offers received have been rejected. It would be most unfortunate if income tax legislation created pressure on these Canadians to sell their shares to foreign companies.

ENTERTAINMENT EXPENSES:

The White Paper Proposals concerning entertainment expenses read in part as follows:

> "5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers ahould be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses..."

This proposal assumes that there are "legitimate business expenses", which should be deductible, and non-legitimate expenses, which should not. Entertainment

expenses are non-legitimate and therefore should not be deductible.

National submits that entertainment expenses are a necessary part of many businesses. They are as necessary to the sale of a company's goods as advertising, travel, products promotion and public relations. They are incurred in order to sell the goods and to earn the income on which tax is paid.

It is submitted that the proposed legislation should not distinguish between business expenses which are legitimate, and therefore deductible, and those which are non-legitimate and therefore not deductible. The test should be twofold. First, is the expense laid out for the purpose of earning income. Second, is it reasonable. If an expense meets both of these tests, then it should be allowed.

In order to conduct its business to the best advantage, National has in the past and will in the future incur entertainment expenses which meet both these tests. It submits that these expenses should be permitted.

It may be that some taxpayers have from time to time claimed entertainment expenses which were not laid out for the purpose of earning income or which were unreasonable. If this is so then the proper action should be to define more precisely when entertainment expenses will be considered to have met both tests and to improve the administration of this portion of the Income Tax Act. It would be wrong, however,

to penalize all taxpayers merely for the purpose of preventing improper practices by a few.

All of which is respectively submitted.

NATIONAL SEA PRODUCTS LIMITED

Per Harold P. Connor

Harold P. Connor
Chairman of the Board

SCHEDULE "A"

Shareholders with 50% Marginal Tax Rate

	At Present	White Paper	
		Mature Co.	National
Dividend Received	$100	$100	$100
Plus Taxable Credit	-	50	-
Taxable Amount	$100	$150	$100
Gross Tax	50	75	50
Less Credit	20	50	-
Net Tax	$ 30	$ 25	$ 50
Amount Retained by Shareholder	$ 70	$ 75	$ 50

Shareholders with 33% Marginal Tax Rate

	At Present	White Paper	
		Mature Co.	National
Dividend Received	$100	$100	$100
Plus Taxable Credit	-	50	-
Taxable Amount	$100	$150	$100
Gross Tax	33	50	30
Less Credit	20	50	-
Net Tax	$ 13	NIL	$ 30
Amount Retained	$ 87	$100	$ 70

SCHEDULE " B "

YEAR		SHARE VALUES	TAX
1971	Say, 100,000 at $9	$ 900,000	
1976	Say, 100,000 at $15	1,500,000	
	Tax at 25% of $600,000		$ 150,000
	Disposition 10,000 at $15	150,000	
1981	Say, 90,000 at $20	1,800,000	
	Tax at 25% of $450,000		112,500
	Disposition 5,625 at $20	112,500	
1981	Shares held after tax paid		
	- 84,375 at $20	1,687,500	

NATIONAL SEA PRODUCTS LIMITED

SUPPLEMENTARY SUBMISSION

TO

THE SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

CONCERNING

THE WHITE PAPER PROPOSALS

FOR

TAX REFORM

NATIONAL SEA PRODUCTS LIMITED

The purpose of this supplementary submission is to comment on two additional aspects of the White Paper which were not referred to in our earlier submission.

EFFECT OF TWO AND ONE-HALF YEAR RESTRICTION ON DIVIDEND PAYMENTS

The White Paper proposes that for a shareholder to receive credit for tax paid by a corporation, the corporation is required to pay dividends - either cash or stock - within a limited period of time, i.e. 2½ years from the end of the corporation's tax year.

The company submits that this is another aspect of the integration concept recommended in the White Paper which will cause serious problems for Canadian corporations and their shareholders. Many companies, including National, for various reasons will not be able to declare cash dividends each year equal to the profits earned. As a substitute for this, the White Paper proposes that stock dividends may be declared, resulting in the same tax relief for the company and its shareholders. National contends that the declaration of stock dividends is not a satisfactory alternative for the following reasons:

1. There is a substantial difference in the relative position of shareholders with large blocks of shares of a company, and with shareholders who own small blocks of shares. The shareholders who own large blocks of stock, and who, incidentally, are probably the individuals who control the company, will want to ensure that stock dividends are paid each year so that they obtain the full credit for corporation taxes. On the other hand, the small shareholder may not be too anxious to receive stock dividends, since this does not produce any cash for him, and may, in effect, result in a net cash outlay.

2. Many companies are precluded from paying stock dividends by virtue of anti-dilution clauses contained in trust deeds securing various forms of debt. These anti-dilution clauses, in effect, preclude the payment of stock dividends in certain cases, and accordingly, these companies would not have the option of distributing their after-tax earnings. In addition, companies, such as National, which have convertible debt would find it difficult to issue stock dividends without making amendments to existing conversion privileges.

3. The frequent payment of stock dividends changes the capital structure of a company each time it is done, and this tends to leave it in a disorderly state. For anything as important as a company's capital structure, this is obviously not a desirable feature.

Once the 2½ year period has run out, the surplus of the company is, in effect, locked in, and the consequences for shareholders receiving any dividends subsequent to this point in time would be serious.

EFFECT ON NATIONAL'S EMPLOYEES' SAVINGS AND PROFIT SHARING RETIREMENT PLAN

Seven years ago, National and its employees created a trustee profit sharing and savings plan, the purposes of which are twofold:

a) to provide every regular employee with an opportunity to share in the consolidated profits of the company, and

b) to furnish a means by which each participating employee may accumulate a fund consisting of his own savings, and his portion of the company's contribution together with the earnings therefrom.

The main objective of the Plan is to provide the employee on retirement with an important lump sum contribution to his future maintenance.

The company contributes annually to a trustee managed fund, ten

percent of its net profits before income tax, and the employee up to five percent of their earnings up to a limit of $750 each. The plan is voluntary, and on December 31, 1969, had 1360 members. Consideration is being given to it becoming compulsory for new employees. The fund at the end of 1969 amounted to $1,960,577.

National considers that its Plan improves morale and provides an incentive to employees, by giving them a desirable form of participation in the success of the company. While the Plan has only been established seven and a half years, it is highly valued by the employees, and its enrollment is growing steadily as employees realize the substantial financial benefits in store for them in future years.

Experience has shown that lump sum payments are used wisely. They provide the retiring employee with the flexibility to reorganize his affairs on retirement. He may pay off a mortgage or other debt, or even start a small business. He may, of course, decide to buy an annuity. In any case, he has freedom of choice.

The White Paper proposal apparently would repeal Section 36 of the Income Tax Act, which allows the taxpayer the option of having a lump sum taxed at the average rate of the last three years. An averaging provision is included in the White Paper, but this is far less favorable to the taxpayer than the present system. The following examples illustrate the effect of the White Paper proposal in different cases in National's Plan:

Example 1 - a married employee with average income of $4,000 drawing a taxable benefit of $13,873 from Profit Sharing would incur a tax increase of 225% over the present provisions.

Example 2 - a single employee earning an average of $4,000 drawing a taxable benefit of $18,054 from Profit Sharing would have a tax liability of 120% greater.

Example 3 - a single employee, with one dependent, with average income of $8,226 per year drawing a taxable benefit of $4,572 from Profit Sharing would incur an 80% increase.

Example 4 - a single employee averaging $2,466 income per year drawing taxable benefits of $2,038 from Profit Sharing would incur a tax increase over the present amount to 150%.

Example 5 - a married employee, averaging $6,000 income per year, drawing taxable Profit Sharing benefits of $5,964, would suffer a tax increase of 140%.

	EXAMPLES				
	#1	#2	#3	#4	#5
1. Present tax under Section 36 at present rates.	$1,200	$2,600	$900	$200	$800
2. Proposed tax basis - with income averaging	$3,900	$5,700	$1,600	$500	$1,900
3. Percentage increases	225%	120%	80%	150%	140%

It will be seen how drastic the increase is on the proposed, as compared with the present basis. Moreover, the burden of the increase generally falls more heavily on those with the lowest income. This is obviously a most undesirable result.

This proposal is a very serious matter. It amounts to retroactive legislation and punishes the results of an employee's life's work and retirement savings. Many employees have reached a stage in their career where they would not have sufficient time to adjust their affairs to cope with the tax reform proposals. It would probably destroy deferred profit sharing retirement plans as we know them.

It is submitted that Section 36, as it operates at present, is fair and appropriate, and we urge its retention for lump sum payments from such profit sharing funds.

Respectfully submitted.

NATIONAL SEA PRODUCTS LIMITED

Harold P. Connor
Chairman of the Board

Per C.R. MacFadden
C.R. MacFadden
Vice President - Finance

APPENDIX "D"

NAME: NATIONAL SEA PRODUCTS LIMITED

SUBJECT: Certain Aspects of the White Paper

Analysis of Appendix "C" by Senior Advisor

This brief has been submitted by National Sea Products Limited.

National Sea Products Limited carries on the business of catching, processing and marketing fish products. This company owns 42 deep sea trawlers of which 24 have been brought into service since 1960. Processing operations are carried on in 16 processing plants, 9 of which are engaged in processing ground fish, other fish and scallops, 5 in the processing of lobsters and 2 in the manufacture of herring meal and oil. Seven of these plants are located in Nova Scotia, 4 in New Brunswick and 1 each in Prince Edward Island, Quebec and Newfoundland. In addition, subsidiaries of National operate a fish processing and cooked fish plant in Rockland, Maine and a shrimp processing plant in Tampa, Florida.

These processing operations in Canada include filleting and preparation of fish for marketing as fresh, frozen, smoked and cooked fish products. National also processes in Canada fresh lobsters, frozen lobsters in the shell, frozen lobster meat, canned lobster, frozen shrimp and crab meat. Waste from filleting operations, amounting to approximately 2/3s of the landed weight, is reduced by further processing to fish meal and other valuable end-products which have become an increasing important part of operations. In 1969 the Company completed construction of its first herring reduction plant in Shippigan, New Brunswick and in 1970 a subsidiary of the Company opened a new herring reduction plant in Burgeo, Newfoundland.

In the year ended August 31, 1969 gross fish landings at the Company's processing plants were 284,000,000 pounds and sales for the same period were $62,000,000.

Sales and distribution of products are handled from sales offices and warehouses in Halifax, Montreal and Toronto, from sales offices in Edmonton, Rockland and Tampa and through regional distributors and agents across Canada and the United States.

The fishing industry is labour intensive. National's processing operations employ approximately 2,100 full time plant personnel and during peak periods employment runs as high as 4,100 persons. There are also approximately 150 full time office and sales personnel. Approximately 2,600 fishermen (including the 600 sharesmen who man the Company's Trawlers) sell their fish to National.

National's shares are listed on the Montreal Stock Exchange and it is a widely-held corporation as that term is defined in the White Paper. It has approximately 1,100 common shareholders and approximately 500 preference shareholders. Eighty percent of all shareholders reside in the Atlantic Provinces.

The brief itself refers to:

(1) The integration of the taxes payable by a corporation and by its shareholders.

(2) The tax on unrealized capital gains resulting from the five year revaluation of the investments held in widely-held Canadian corporations.

(3) Entertainment expenses.

A supplementary brief has also been filed, relating to:

(1) The company's profit-sharing plan with its employees; and

(2) The White Paper proposal that dividends be required to be distributed in a period of 30 months after being earned.

There is attached the usual summary of existing tax laws, White Paper proposals and principal points of the brief.

Name: NATIONAL SEA PRODUCTS LIMITED

Principal Subject: Tax Integration or Grossing-Up of Canadian Dividends

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not provide for any integration of tax.	The White Paper proposals relating to integration of corporation taxes and shareholders' taxes on dividends are contained in Chapter 4. These proposals have also been reviewed in the Special Study entitled "Grossing-up of Canadian Dividends."	Pages 2 to 9 of Brief This portion of the brief states: (1) National submits that the proposals relating to dividend tax credits tend to "interfere seriously with economic growth" by favouring investment in mature companies that do not require new equity capital and by discouraging investment in growing companies that do need new equity capital. (2) As the expanding company has not paid any substantial tax relative to its cash flow there is little or no creditable tax that can be passed on to its shareholders in the form of a dividend tax credit. (3) Had the White Paper proposal been in effect in 1968 and 1969, the shareholders of National would not have been entitled to any dividend tax credit in respect of dividends received. (4) There may be some logic in permitting a dividend tax credit to a shareholder only to the extent that the paying corporation has paid tax. But logical or not, such a policy, if implemented, will seriously interfere with economic growth in Canada and particularly with economic growth in the Atlantic Region. This becomes apparent on considering the ability of an expanding company to raise share capital.

Name:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		(5) As shareholders of all Canadian companies are treated equally under present tax legislation, National does not suffer any disadvantage merely because it is an expanding company. However, under the White Paper proposals, National will be at a considerable disadvantage in raising share capital compared with the mature company, whose shareholders will be entitled to a substantial tax credit. Obviously, the potential investor will prefer to invest in the shares of the mature company rather than in those of the expanding company.
		(6) The anomalous result is that the White Paper Proposals induce Canadians to invest in the shares of mature companies which do not need new share capital and discourages the investment in expanding companies which do need share capital. It will encourage Canadians to trade on the stock market in the shares of mature companies but will discourage the purchase of new issues of expanding companies. To use the words of paragraph 1.10 of the White Paper "investments needed for productivity...(will be)... rejected in favour of less desirable alternatives just because of their tax consequences."
		(7) Indeed from the prospective shareholders point of view, this kind of legislation when coupled with the White Paper Proposals, creates little or no incentive to invest in a company such as National whose principal assets are located in the Atlantic Region.

Name:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		(8) This portion of the Company's brief can be summarized as follows: (a) The Company supports the White Paper objective of seeing that the tax system does not interfere seriously with economic growth; (b) The specific White Paper Proposals concerning dividend tax credits run counter to this objective; (c) The proposals, if implemented, would encourage trading on the stock market in the shares of mature companies. It would impair the ability of expanding companies to sell new issues of shares; (d) The proposals hit hardest at slow growth areas such as the Atlantic Region which require massive injections of capital (including share capital) by reducing the effectiveness of Canada's incentive policy of permitting accelerated capital cost allowances on investment in new vessels, production equipment and plant.

Name: NATIONAL SEA PRODUCTS LIMITED

Principal Subject: The Capital Gains Tax
- Tax on Unrealized Gains Resulting from Five Year Revaluation

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not levy a tax on capital gains.	3.33 Taxpayers other than widely-held Canadian corporations would include only one-half of their gains on the sale of these shares in taxable income and deduct only one-half of their losses. However, they would be required to revalue these shares to market value every five years and take one-half of the resulting gain or loss into account 3.36 The proposal that the accrued gains or losses on those shares be taken into account every five years is one of two exceptions to the general rule that capital gains and losses would be taxable only when they are realized. (The other exception concerns taxpayers who leave Canada.) Periodic revaluation would reduce somewhat the value of the half-gains rule. It would reflect the fact that these shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily at the time of his choosing. The shares of private companies do not have the same marketability.	Pages 9 to 11 of Brief This portion of the brief states: A number of persons engaged in the management of National own large blocks of its common shares. They have no desire to sell these. The investment by managers in their employers shares is generally regarded as a healthy incentive. National so regards it. In spite of this the White Paper Proposals, if implemented, would place financial pressure on the shareholders to sell a portion of their shares every five years in order to pay taxes on profits that have not been realized. It is respectfully submitted that such action is grossly unfair to these shareholders. It is also unfair to National as it impairs the incentive which exists when a manager is a substantial investor in the company that employs him. More than 90% of the outstanding common shares of National are owned by Canadian residents. It is submitted that the pressures on holders of large blocks of shares to sell portions of their holdings will stimulate the takeover of many companies by foreign interests. Schedule B illustrates the effect of taxing unrealized gains and the resulting disposition of shares to pay that tax.

Name:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	3.37 Periodic revaluation would also reduce the "lock-in" effect that might well otherwise occur. If a taxpayer faces a tax on the sale of an investment, and that tax is postponed if he holds on to the investment, he may feel "locked in". As long as he holds, he would have, say, $100 working for him. If he sells, he would have only, say, $90 or $95 to reinvest. Since periodic revaluation would reduce this lock-in effect, it would reduce what might otherwise be an obstacle to the workings of the capital market. Revaluation would also make it feasible for the government to classify more corporate reorganizations and mergers as tax-free transactions than would otherwise be the case, thus removing a tax barrier that might otherwise have impeded transactions that are desirable for economic reasons. Finally, it would reduce the tax postponement which would otherwise result from the treatment suggested in paragraph *3.42* to those cases where the lack of marketability of the assets made the treatment compelling.	Over the past few years several United States companies have expressed an interest in acquiring control of National. However, the shareholders of National wish to retain their investment in this Company and all offers received have been rejected. It would be most unfortunate if income tax legislation created pressure on these Canadians to sell their shares to foreign companies.

Name: NATIONAL SEA PRODUCTS LIMITED

Principal Subject: The Capital Gains Tax
- Tax on Unrealized Gains Resulting from Five Year Revaluation

Present Tax Law	White Paper Proposals	Principal Points of Brief
	3.38 The process would not begin until five years after capital gains become taxable. Beginning in the fifth year, individual taxpayers would revalue their holdings of shares of widely-held Canadian corporations in each year in which they attain an age that is divisible by five. Corporations would also revalue their holdings of these shares every five years, likely on the fifth anniversary of incorporation and each other anniversary divisible by five. Dispersing the valuation process through a five-year cycle would reduce the pressure in any particular year—the pressure of the work load on the administration and the pressure that might otherwise develop on market prices every five years. To further disperse this latter pressure, it is proposed that revaluation take place as of the end of the month in which the significant birthday or anniversary takes place.	

Name: NATIONAL SEA PRODUCTS LIMITED

Principal Subject: Entertainment Expenses.

Present Tax Law	White Paper Proposals	Principal Points of Brief
The present Income Tax Act permits the deduction from income of reasonable sums of business promotion expenses.	5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.	Pages 12 and 13 of brief. This portion of the brief states: "National submits that entertainment expenses are a necessary part of many businesses They are as necessary to the sale of a company's goods as advertising, travel, products and public relations. They are incurred in order to sell the goods and to earn the income on which tax is paid. It is submitted that the proposed legislation should not distinguish between business expenses which are legitimate, and therefore deductible, and those which are non-legitimate and therefore not deductible. The test should be twofold. First, is the expense laid out for the purpose of earning income. Second, is it reasonable. If an expense meets both of these tests, then is should be allowed. In order to conduct its business to the best advantage, National has in the past and will in the future incur entertainment expenses which meet both of these tests. It submits that these expenses should be permitted. It may be that some taxpayers have from time to time claimed entertainment expenses which were not laid out for the purpose of earning income of which were unreasonabl If this is so then the proper action should be to define more precisely when entertainment expenses will be considered to have met both tests and to improve administration of this portion of the Income Tax Act. It would be wrong, however, to penalize all taxpayers merely for the purpose of preventing improper practices by a few."

APPENDIX "E"

S U B M I S S I O N by

Atlantic Provinces Economic Council

to the

Senate Committee on
Banking, Trade and Commerce

on the Government's White Paper,

Proposals for Tax Reform.

May 20, 1970

Summary

The Atlantic Provinces Economic Council recognizes the need for a revision of income tax legislation in Canada. The general view of the Proposals for Tax Reform of a need for greater equity in the tax system without impinging on economic growth is accepted.

We submit that the use of the tax system is neither the most efficient nor the most effective method of inducing economic development in those areas of the nation which suffer from regional disparities. However, it is most important that the tax system not offset the impact of incentives available under other policies designed to achieve specific objectives. This is especially significant in the Atlantic Provinces because of the policies and programs designed to broaden the industrial base of the region. Taxation policies must not be permitted to dampen the effects of these programs. Taxation policies do, however, generally influence industrial, economic and social development. It is in this light--the way in which the tax proposals could help or hinder the economy of the Atlantic Provinces--that we have viewed the Proposals.

Small businesses ecounter numerous problems relative to their larger counterparts. The most important handicap with which they are burdened is the difficulty in procuring funds for expansion and modernization. They are hampered by limited access to funds

and higher costs compared to larger industrial concerns. This principle of the need of small businesses for expansion capital was recognized and legislation so implememted through the establishment of the dual tax rate on corporate income. The Proposals for Tax Reform does not recognize this principle. We believe this omission could have serious consequences on both the national economy and the regions which compose it. Thus, although, we are in accord with the principles on which the White Paper is based, we do have some reservations concerning the mechanics advanced as a means of translating the principles into action.

The aim of establishing a degree of integration between the personal and corporate income tax system we view with general accord. However, we do have serious reservations concerning the proposed taxation of unrealized capital gains, particularly the proposition to tax deemed gains on the shares of widely-held Canadian corporations every five years. Such a move, we feel, is unwise, unjust and unsuitable to the present stage of the nation's development. Not only does this represent a significant departure concerning taxation policies in Canada, it also could impose a deterrent to the investment so necessary for the continuing economic advance of the nation.

Although we recognize the need for a system of income-averaging, especially when capital gains to varying degrees are drawn into the tax base, we have reservations concerning the complex method proposed for doing so. We believe it falls short

of meeting the taxation canons of simplicity, ease of administration and ease of collection.

We concur with the proposals to raise personal exemptions and the wise decision to relate any change in deductions for dependents to changes in national social security and social development programs. Proposed deductions for child care expenses, employment expenses, moving expenses related to changing jobs; the exclusion from income of living allowances paid under the Adult Occupational Training Act, taxation of unemployment insurance benefits and deduction of payments are all proposals that would contribute to the progressive social and economic structural change necessary for economic development.

The stringent measures proposed for the treatment of business expenses we view as unduly harsh. Existing legislation concerning treatment of business expenses for tax purposes and the proposal to allow general deduction of employment expenses for wage and salary earners should be sufficient to offset any imbalance which has occurred in the past. Moreover, implementation of this suggestion as outlined in the White Paper could have a serious disruptive effect on the need of businessmen and professionals to become familiar with new developments in their respective fields. This is especially important to those engaged in such pursuits where large internal research facilities are not available and who are located in areas removed from the mainstream of technical, managerial and administrative development.

Although the aim of alleviating the tax burden of those in the lower income categories cannot be disputed, and although realities compel that the middle income groups bear the brunt of the cost of this, we would recommend that the government lighten this load if revenue yields exceed those anticipated. It is also imperative that the level of taxation in Canada not become so onerous that it differs significantly from those countries with which the nation must compete for both personnel and capital. This is especially important with respect to those highly trained, highly mobile personnel who, to a great extent, would be hit hardest if the tax proposals were to be implemented as legislation.

We find it difficult to agree with the proposal which would not recognize the principle inherent in the establishment of the dual tax rate on corporate income, especially since the concessions proposed do not seem sufficient to offset the increased burden. The principle which was taken into account when the dual rate system was originally established--that small businesses are hampered in obtaining funds for expansion--is still relevant today. Therefore,we do not feel the integration proposal or the partnership option is sufficient to offset the increased tax burden. If abuse is so flagrant that the present system could not be retained, or if this seriously distorts the intent of the entire tax package, then we would propose that a system be adopted where the need of small business for expansion capital is recognized.

Submission on Proposals for Tax Reform by the Atlantic Provinces Economic Council

Introduction

The Atlantic Provinces Economic Council welcomes this opportunity of submitting its views on the Proposals for Tax Reform. The Council commends the Government particularly on the method by which it has seen fit to submit its proposals to public scrutiny and appraisal before undertaking to make them law. Such a gesture is certainly a welcome one to the nation's population.

The Atlantic Provinces Economic Council is an independent, non-political, non-governmental organization formed in 1954, to promote and encourage the economic and social development of the whole Atlantic region so that Nova Scotia, New Brunswick, Prince Edward Island, and Newfoundland may share fully in, and make their maximum contributions to, Canada's national development.

The Atlantic Provinces Economic Council strives to achieve this purpose through the pursuit of four primary objectives:

--The encouragement of substantial increases in employment and productivity.

--The promotion of the most efficient use of the region's total resources--both human and material.

--The recommendation of public policies and programs that will stimulate economic and social development.

--The encouragement of inter-provincial and federal-provincial co-operation and co-ordination.

The Council's work is financed mainly through membership contributions received from individuals, organizations and businesses

interest in the Council's aims and anxious to share in the development of the region.

It will be appreciated that the Proposals for Tax Reform are of great concern to the Atlantic Provinces Economic Council. This Submission is presented so that the Council's views may be publicly expressed and with the hope that some consideration may be given to these views.

Scope of the Submission

The Atlantic Provinces Economic Council deems it a very great honour and privilege to be permitted to present these, its views, on the Proposals for Tax Reform released by the Minister of Finance on November 7, 1969. The Council appreciates the tremendous amount of effort which has culminated in these proposals which will form the basis of the income tax system in Canada in the decades ahead.

This is not the first time that the Council has presented its views on tax reform for the nation. In 1963 the Council was pleased to offer a Submission to the Royal Commission on Taxation. At that time the Council solicited the support of the Government of Canada in the activation of a comprehensive development scheme to aid the region in alleviating the disparities which existed and still exist between the region and the great nation of which it is a part. Since that time, numerous developments have taken place which bode well for the economic growth and development of the Atlantic Provinces. The most important occurrence, of course, has been the formation of the Department of Regional Economic Expansion. Most welcome though is the renewed and avowed commitment of the federal government to regional economic development.

Since the early sixties it has been realized, and policy amended accordingly, that there are better ways of inducing economic development than through the tax system. Taxation policies do, of course, have a significant effect on the industrial, economic and

social development of the country but it has been recognized that the specific goal of regional development may be more easily achieved through more direct measures designed to promote industrial location in the region.

Thus, at this time, the concern with the tax system is not how it may be tailored specifically to induce regional economic expansion but the effect it would have on the general economic climate of the nation and particularly of the Atlantic Provinces. The views expressed in this Submission, then, concern those proposals which if implemented, could affect the general economic well-being of the Atlantic Provinces although we have felt compelled to comment more generally on the intent and probable repercussions of others.

OBJECTIVES OF THE TAX SYSTEM

Equity versus Growth

One general area of concern frequently expressed by opponents of the White Paper is that by opting for equity in the tax system, inadequate provision has been made for stable economic growth. The equity principle of taxation is certainly not a principle to be lightly dismissed, but it is necessary that it not disrupt the other functions of the tax system.

An evolution is occurring in our society at this time--an evolution towards a mass social conscience. The ready availability of material goods in a number of cases has led people to concern themselves with other less material things. Thus, a concern is being expressed about the need for policies to alleviate air and water pollution and also for noise abatement. Other important concerns have been of the plight of those in urban ghettos; the welfare of the old and the disabled; the well-being of the native peoples of our country and with those regions of the country which are unable to contribute their maximum potential to the nation or whose inhabitants are, consequently, unable to share fully in the fruits of economic and social progress. Awareness of these needs has led all levels of government to implement policies and programs tailored to suit those social injustices which must be eliminated.

Thus, when the consensus of society is that these problems must be removed, it is only reasonable that a tax system be designed that

would aid in the process. With social illnesses of this type, it is all too easy to miss the other goals of society. In achieving equity in the tax system, it is thus easy to ignore the opportunity cost of the economic growth which might be foregone. We would caution the government that if it is seen that the proposals seem to be levying too great a premium on the economy, that the system be analyzed to see if the equity may be achieved at less cost or if alternative policies might not be better suited.

The inclusion of capital gains into the income tax base is a gesture which may provide a more equitable form of taxation in the nation. It is likely that the absence of taxation on many forms of capital gains may have led not only to social injustices, but also to abuses of the tax system through sophisticated tax avoidance techniques.

Another basic principle which would seem to eliminate much of the social injustice prevalent in the existing system is the attempt to establish a fully integrated income tax system. This is a principle which cannot be disputed on equity grounds, but which could have an unfortunate effect on those parts of the country which must rely on a number of small industries for their economic uplift. The specific proposal in the limelight at this point is, of course, the proposal for the elimination of the low rate on the first $35,000 of taxable corporate income. There are those who would advocate that any form of corporate taxation is detrimental to economic growth. There are also those on the other side of the spectrum who would suggest that a regressive rate structure for the taxation of corporate income be adopted. Adoption of the former would seem to ignore the equity

principle of taxation while the latter would be a disincentive to national growth. In the light of the revenue needs of government in our society and the need for equity in our tax system, it is necessary that corporations pull their fair share of the taxation load. Equity must not, however, be permitted to disrupt the economic climate of the nation, particularly those parts of the nation most vulnerable to economic malaise.

We do not mean to imply that all those proposals which aim at greater equity in the tax system involve a trade-off between equity and growth. It is possible, however, that in certain instances this is the case. If it is recognized as being such, we would implore the government to seek alternatives which would achieve equity while having, at best a neutral or positive effect on economic growth, price stability and the other basic economic objectives of the country.

TAXATION OF PERSONAL INCOME

The government is to be commended for its attempt to create an equitable tax system for the country. The broadening of the tax base to include capital gains, generally, into the income tax base is a move certain to remove much of the social injustice of the present system and to alleviate, if not completely obliterate, one of the most flagrant forms of tax abuse in the present system.

The aim to establish a degree of integration between the corporate and personal income tax system is also a worthy objective although we do have reservations about the method proposed to achieve this. The reservation will be expressed in the section on the taxation of business income.

Any tax system that would draw capital gains into the income stream for tax purposes must, of necessity, employ some form of concession so that gains realized on the sale of an asset may not be subject to unduly harsh tax treatment by being taxed at a marginal rate substantially higher than that one in which the taxpayer usually falls. The best way of doing this would seem to be a form of income-averaging. Such a tool should meet the conditions of simplicity, ease of administration and ease of collection. We would suggest that the proposal outlined in Proposals for Tax Reform falls short of meeting these conditions, especially the first one.

Any policy which would lighten the tax burden of those less fortunate than most Canadians is, of course, a welcome one, if it does not

impose unduly harsh treatment on those in the other income categories. Thus, the proposal to increase personal exemptions of single taxpayers from $1,000 to $1,400 and of married taxpayers from $2,000 to $2,800 is a welcome one. It is especially heartening that 750,000 persons now subject to tax would be freed of this burden.

The proposals relating to deductions for taxpayers are also viewed with general accord. The decision to delay any change in deductions for dependents until they can be related to changes in the nation's social security and social development programs is a reasonable and wise move. At this juncture we might also stress our belief that any change in these programs should include the removal of a number of universal welfare payments and their establishment on a more selective basis. Not only would this enable a comprehensive form of aid for those in need but it would permit a more efficient system of aid and generate a higher return for the taxpayer's dollar.

The emancipation of the female, the rapidly changing rural-urban distribution of population, the emergence of the service sector as a significant employer of women--all the major trends which have accelerated in the post-war period--point to a rapidly changing society. These trends coupled with the increased population resulting from the post-war baby boom, many of whom are career-oriented wives and mothers, point to the need for some form of compensation for expenses incurred by both parents holding a job. Thus, we view the proposal for the deduction of child care expenses as a farsighted view by the government. So also is the deduction to be permitted for employment expenses. This should do much to eliminate the discrimination against these people relative to those in business and the professions.

The deduction to be provided for moving expenses when a taxpayer moves from one residence to another which is ten miles closer to his new job should foster the mobility necessary in today's rapidly changing technology-oriented world. It has long been recognized that measures that will stimulate labour mobility are necessary with the rapid pace of structural change in the emerging post-industrial society. This is also important within the context of regional development especially becuase of its necessary relationship to the growth centre concept. It should be noted that any policies designed to stimulate geographical mobility should be related to those which would foster occupational mobility of the labour force. Thus, this proposal fits well with the proposal that would permit the exclusion of living allowances paid under the Adult Occupational Training Act from income. The proposal which would draw unemployment insurance benefits into the income tax base and allow the deductions from income for tax purposes, payments into the Unemployment Insurance Commission Fund, we view as a wise one. This measure should tilt the sensitive balance towards incentives to work rather than passive acceptance of state welfare benefits.

While there has been discrimination between wage and salary earners and those in business and professionals in the past in regard to their ability to claim business expenses as a tax deduction, we feel that the proposals for deduction of employment expenses should compensate for this. Although business expenses as tax deductions have been subject to abuse, we contend that if the stringent measures outlined in the White Paper were implemented they could impose hardships on the economy. It must be recognized that legitimate business expenses represent significant and necessary costs for business. It is especially

important in the professions where lack of time forces those employed in these fields to attend conventions to keep abreast of the numerous technological achievements which characterize this age. If the proposals dealing with tax deductions of business expenses were applied as rigidly as they appear in the White Paper, they could conveivably have a most restrictive effect on enterprise in the economy by forcing businessmen and professionals to become "locked-in." Knowledge is not a stock commodity but is, rather, a flow which must be fed continually if the economy is to progress in an advanced industrial world. We would suggest that present restrictions are sufficient to avoid misuse of this provision.

Although we accept the principle of drawing capital gains into income for tax purposes, and although we believe this system has more merit than one similar to that of the United States where an income tax and a capital gains tax are two separate systems, we have serious reservations with regard to the proposed taxation of one-half of the unrealized capital gains on the shares of widely-held Canadian corporations every five years. Although this proposal might remove an obstacle which could create problems in the capital market by creating a "lock-in" effect and avoid indefinite tax postponement, we feel that this proposal is an undue one. It could, conceivably, handicap the capital markets of the country by providing a disincentive to invest. Such a disincentive should not be permitted to be enacted into the laws of our country--one which needs substantial investment for economic growth.

While it is a commendable gesture to relieve some of those in the lower income classes completely of an obligation to pay income

tax and to lower the amount of income tax paid by married taxpayers earning up to about $9,100, there seems to be an excessive tax burden placed on the middle income classes relative to the present system. If the middle income class is arbitrarily defined as the $8,000 to $15,000 income group, we may view some of the immediate effects of the new proposals. A single taxpayer with no dependents would find himself paying an extra $124 if he had a gross income of $8,000; $251 if income were $10,000; $313 if $12,000; and $299 if $15,000. For a married taxpayer with no dependents there would be tax relief of $71 for a taxpayer with an income of $8,000; an additional tax of $56 on an income of $10,000; $157 on an income of $12,000; and $160 if income were $15,000. In the case of a taxpayer with two dependent children under age 16, tax relief of $83 would be accorded a taxpayer with an income of $8,000. Additional tax loads on income above this would be $17 on income of $10,000; $128 on income of $12,000; and $177 on income of $15,000. We submit to the thesis that this additional tax burden would not hamper the economy by cutting down substantially on investment since it could simply re-allocate voluntary personal saving. Moreover, voluntary personal saving accounts for only a small proportion of gross saving. However, we consider that this is one case where it is dangerous and heartless to talk in aggregates. Although it is laudable to accord some relief to those in the lower income brackets, we would suggest that so much of the costs of redistribution of income should not fall on those in the middle income classes.

We view the Proposals for Tax Reform as simply that--an attempt at a means of tax reform for Canada--and proposals which would establish a tax system that is consistent with the achievement of social

and economic objectives for the country in the late twentieth century. Thus, we do not view proposals simply as a method of bringing in "back door" tax increases. However, if new estimates of tax revenue do exceed revenue yields under the present system we would suggest that the relief should go to those who will be hit hardest, those in the middle income classes. We would also suggest that this be the approach taken if actual revenue yields, after the implementation of the new system, exceed those which were anticipated. If extra temporary tax burdens seem necessary, for example, as a tool to contain demand-pull inflation, or permanent tax increases seem necessary to finance new programs, then the people of Canada trust their government to present them in this guise.

Thus, if revenue yields from the new system exceed those anticipated, even if they occur from an increased tax base on those in the higher income classes, we would recommend that the principle of progressive taxation of personal income be recognized by lightening the tax load on those in the middle income classes.

TAXATION OF BUSINESS

The most significant tax proposal as far as the Atlantic Provinces are concerned is that which would allow for the taxation of business profits of incorporated companies at a flat rate of 50 per cent. This would mean that the low rate of 21 per cent on the first $35,000 of taxable profit would be eliminated. If this proposal were to become part of taxation, the fear is that this could eliminate much of the business activity now located in that region of the country. It cannot be argued that the present tax rate should be maintained simply because the precedent has been set, of course, but there are other substantial reasons for the maintenance of this taxation principle, if not for keeping the system as it now stands.

The basic aim of the proposals concerning taxation of business income is an equity one, as are most of the other basic precepts in the Proposals. Regarding the taxation of business income, equity will, according to the Proposals for Tax Reform, be achieved through an integration of the personal and corporate tax systems, predominantly through the tax rates. While all taxable corporate income is to be taxed at a flat 50 per cent rate, taxable business income received by an unincorporated business would be taxed at the owner or owner's personal rate which would rise to a maximum rate of 50 per cent after the system has been phased in completely. It is also suggested that the 50 per cent corporate rate would not differ significantly from most nations with which Canada must compete for international capital.

The removal of the 21 per cent rate on the first $35,000 of taxable corporate income without some form of compensating benefit could be a crippling blow to the country and especially to the Atlantic Provinces, simply because the region's business community is so predominantly occupied by small business. The major reason advanced for the removal of this rate in the Proposals is to eliminate a major source of tax avoidance which was gained through companies splitting into a large number of smaller companies to take advantage of the low rate. Another reason advanced is based on equity grounds. It is maintained that a person who gains a living through wages and salaries should not be penalized at the expense of one who receives income through an enterprise. One must, however, remember the element of risk involved in the establishment and maintenance of enterprise. The removal of the rate would create a tax on entrepreneurship. Such a move would be unwise, unjust and inappropriate to the present state of development of a country which relies so heavily on primary-based exports and which requires the introduction of new risk-taking ventures. This is particularly true of the Atlantic Provinces which depend to a large degree on three types of primary products for export purposes and which are just now stepping out of the embryonic stage of economic development.

While it is necessary to view the proposal for the elimination of the dual rate corporate income tax in the context of the rest of the tax proposals--specifically those relevant to the partial integration of personal and corporate income tax--it is also necessary to look at the reasons cited originally for the use of a dual rate of corporate taxation.

When the principle of a dual rate of corporate taxation was adopted as legislation in 1949, the basic reason given for it was that small businesses did not enjoy the freedom in the capital market of their larger brothers and that some concession was needed to enable them to raise capital. At that time the Minister of Finance had this to say:

> "The House will at once recognize this as tax relief for small businesses and will, I trust, be heartily in accord with the policy. Our country as a whole owes a great deal to the small family type of business. They have to struggle along, grow and develop in competition with large and well financed corporations whose activities may be nation-wide. My own belief is that small business should be encouraged and it seems to me that a useful way to do this is lower the tax and take less out of the funds they need for growth and expansion."[1]

The reason then was that more funds be made available for expansion of small business.

The criterion given for the elimination of the dual rate in the Proposals for Tax Reform seems to be that the abuse of the provision may be eliminated. Nowhere is it stated in the Proposals that smaller businesses have less need for expansion capital, nor is it cited that changes in the capital market structure of this country have so altered, in comparison with the time when the dual corporate tax rate was first introduced. Rather, the need of small business for expansion capital seems to be completely ignored. The sole criterion for the proposal seems to be an equity one. The proposals seem only concerned that some taxpayers may be able at present to have their income taxed at substantially lower marginal rates than wage and salary earners. Although it is true that owners and/or shareholders of small businesses

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[1] Budget Speech, Ottawa: Queen's Printer, 1949, p. 14

could, by channelling funds through the corporation, ensure that this income would not be taxed at marginal rates in excess of 50 per cent, under the other proposals outlined in the White Paper, the maximum marginal tax rate would not exceed 50 per cent. Thus maintenance of the dual rate of 21 per cent on the first $35,000 of taxable corporate income and 50 per cent on the excess coupled with the maximum 50 per cent personal rate would seem to allow a partial integration of the corporate and personal income tax structures. By changing the tax credit accordingly, if need be, equity could be achieved without creating a serious obstacle for the smaller businesses in the country. If it is felt that taxpayers are taking advantage of the low rate available, then a more stringent business test should be used by the Department. A business could be required to apply to the Department to show that it has met all the statutory conditions necessary.

Another reason cited for the need to eliminate the dual rate corporate tax structure is that it was abused by those who set up numerous companies which each could claim corporate taxable income of less than $35,000.

> "Some taxpayers were not content with obtaining only $35,000 at the low rate annually. By incorporating several companies they sought to multiply this amount several times over. Given the almost infinite flexibility in the share structures of corporations, it was possible for some to keep one step ahead of every change in the law designed to restrict taxpayers to one amount of $35,000 annually."[2]

The original legislation aimed at eliminating this misuse was repealed. It was replaced by a "test based on ownership of 70 per cent

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[2] Proposals for Tax Reform, Ottawa: Queen's Printer, 1969, p. 47.

or more of all the issued common shares of the capital stock of the relevent two or more corporations at any time in the year."[3] This has proved inadequate for the task and new legislation was adopted in 1963. We believe that the enactment of Section 138A(2) of the Income Tax Act should be sufficient to block the way for abuse of the dual rate structure. This section reads as follows:

> "(2) Where, in the case of two or more corporations, the Minister is satisfied
> (a) That the separate existence of those corporations in a taxation year is not solely for the purpose of carrying out the business of these corporations in the most effective manner, and
> (b) that one of the main reasons for such separate existence in the year is to reduce the amount of taxes that would otherwise be payable under the Act the two or more corporations shall, if the Minister so directs, be deemed to be associated with each other in the year."[4]

Thus, through ministerial discretion, a dual test of business purpose and tax reduction purpose may be imposed. This, we would suggest, should be sufficient to cover tax evasion and avoidance through misuse of the provision.

Another reason given for the elimination of the present form of corporate taxation is that, in a number of cases, income tax could not only be postponed but actually avoided by a series of transactions

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[3] Statutes of Canada, 1950, Chapter 40, Section 15

[4] Income Tax Act, Section 138 A(2), Ottawa, 1963.

which could culminate in the income being classed as a capital gain and, therefore, not subject to tax.

> "Shareholders also developed sophisticated schemes to obtain the profits from their corporations without paying personal tax. Many of these schemes involved a sale of shares of the corporation for a tax-free 'capital gain,' although other steps in the scheme resulted in the shareholders still controlling the business."[5]

Under the Proposals for Tax Reform, capital gains realized on the sale of shares or assets would be fully drawn into personal income and be taxed at the taxpayer's marginal rate. This would certainly invalidate this criticism of the existing system.

Another proposal which would violate the intent of the dual rate is that which would permit the taxpayer to claim on the personal income tax, full credit for the corporation tax paid by the company only if retained earnings are distributed within two and one-half years from the corporation's taxation year. If the dividends were released in the form of stock dividends, then the proposal is a fair one and would not violate the needs of the corporation. However, if the company were forced to distribute cash dividends the effect could be harmful to the corporation. Enactment of such a provision could have a serious effect on the ability of the small corporation to obtain or retain funds for expansion.

The only concession offered in the Proposals for Tax Reform is that a "partnership option" be made available if certain limitations are met. These restrictions include the provision that it be made clear what portion of the profits each shareholder is going to receive,

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[5] Proposals for Tax Reform, Ottawa: Queen's Printer, 1969

that all shareholders be either individuals or corporations resident in Canada, that proof of ownership of shares be provided and that, in the case of Canadian corporations holding shares, the corporation in question have the same fiscal year-end as the corporation holding the shares. Thus, each shareholder would be able to draw his portion of the corporation's profit into his personal income tax base. This proposal alone does not, however, seem to be enough compensation for the proposed harsher treatment of corporations. This judgment is the conclusion reached by the Royal Commission on Taxation on this point.

> "The partnership option does not by itself appear to provide a sufficient amelioration of the serious results of complete withdrawal of the low rate of corporation tax."[6]

If the dual rate is to be eliminated, the principle so established should not. While the Carter Commission did propose that the dual rate be withdrawn, concessions were to be granted so that principle would remain.

Thus, although the Carter Commission did aim at greater equity in the tax system, they realized that some compromise should be given to the simplicity objective of taxation, and to the national objective of economic growth.

> "Despite our great reluctance to recommend the complex tax provisions that are inevitable when the tax structure is used to achieve specific economic purposes, we believe it would be unwise to recommend withdrawal of the low corporate rate without making some adjustment within the tax system designed specifically to assist new and small business. We are concerned that if we did not propose a technique within the tax system, either our major reforms would be rejected

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[6] Report of Royal Commission on Taxation, Ottawa, Volume IV, Part C, Appendix 1, p. 719.

> because aid to new and small businesses outside the tax system might be thought to be impractical, or they would be implemented without the adoption of compensating policies outside the tax system, to the detriment of new and small businesses. We have decided that a concession to such businesses within the tax system that would assist in the financing of capital expenditures would reduce the major difficulties that confront many of these businesses."[7]

The specific proposal recommended by the Commission was designed to accomplish the following objectives.

> "1. To reduce the cost of capital to new businesses or rapidly expanding small businesses where those who control the business are not in a position to put up much capital themselves or to raise capital cheaply . . . .
>
> "2. To help fill the gap in the present capital market with respect to longer term financing of capital investment . . . .
>
> "3. To avoid creating pressure on taxpayers to change the way they conduct their affairs in order to secure a tax advantage.
>
> "4. To promote the expansion of businesses rather than to perpetuate stagnating or declining businesses."[8]

The Carter proposal would also have avoided the discrimination inherent in the present system between corporations, and proprietorships and partnerships. At this point we might also suggest that, contrary to the contention of the Proposals for Tax Reform, closely-held corporations must also compete not only with other closely-held corporations, proprietorships and partnerships but also with widely-held corporations. We believe this to be more generally true than the Proposals would seem

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[7] Ibid., p. 277.

[8] Ibid., p. 277.

to imply, despite a small number of exceptions where it is absolutely true, (as in the case of two of the country's largest retailers). The Carter proposal would avoid many of the avoidance problems that exist in the present system by subjecting businesses to a business test before they could become qualified. It would also achieve the necessary end of facilitating the raising of funds for capital expansion since accelerated capital cost allowances are, in effect, interest-free loans. Since the businesses would be forced to acquire fixed assets with the funds so obtained in a relatively short period, there would not be a form of permanent subsidization.

In order to qualify, the majority interest in the corporation would have had to be owned by Canadians. Also, at least 70 per cent of the beneficial interest either direct or indirect would have had to be held by one individual who did not have a beneficial interest in another business of more than 30 per cent which was qualified or had been qualified for the accelerated write-off of capital costs.[9] Another test would be that:

> "The assets, after capital cost allowances, of the businesses and of other businesses controlled by the same shareholders should be less than $1 million and gross revenues should be less than $10 million."[10]

The system of accelerated capital cost allowances permitted under the Carter proposal would have been to allow qualified businesses "to claim capital cost allowances up to the full actual capital costs in computing taxable income in any one year, or over a period of years,

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[9] Ibid., p. 278.

[10] Ibid., p. 278.

to a total value of $250,000, without regard to the maximum capital cost allowance rates specified in the Regulations."[11] Recaptured capital cost allowances realized on the sale of assets would be brought into taxable income. Also, capital cost allowances could not be deducted again after having been once deducted. Another provision to ensure that the allowance would be used as intended was that a business which ". . . exhausted its $250,000 of accelerated capital cost allowances, or became disqualified by the passage of the ten-year period, would not again become qualified."[12]

Although the increased personal tax credit was one of the alternatives suggested by the Carter Commission, it appears to have been rejected because of the fact that this would aid the individual shareholder rather than the corporation. We would suggest that this proposal as adopted by the White Paper would do this and that it does not meet the original aim of the dual rate of making more funds available for capital expansion. We would recommend, then, that the principle, if not the actual structure, of the present dual rate corporate tax system be retained. A marginal cost approaching ten thousand dollars, we would suggest, is a significant, if not a prohibitive cost to small businesses especially when it is related to foregone investment. This is particularly so in the least economically developed region of the country.

If it is felt that the administrative difficulties of policing the present system are too cumbersome and not efficient, then we would

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[11] <u>Ibid</u>., p. 279.

[12] <u>Ibid</u>., p. 280.

suggest a system along the lines of the Carter proposal be adopted. This would avoid individual misuse of the tax system while aiding small businesses to expand their capital assets and, thus, their productive capacities. We do not feel that a partnership option is sufficient to offset the handicap, nor do we feel the tax credit system proposed is enough to overcome the obstacles faced by new or small businesses.

Our recommendation on this point should be rather evident at this juncture. The compensations of being able to claim full credit for taxes paid by a closely-held business on the taxation of business income with the stipulation that dividends be paid out within two and one-half years of the company's fiscal year-end, the allowance of using the partership option with the given stipulations and the lowered marginal personal rates do not, we believe, compensate for the elimination of the dual rate of corporation tax. Neither do they recognize the need for the dual rate. We recommend that the dual rate be maintained with appropriate changes in the tax credit if this would not seriously disrupt the reform package. If this is not seen as desirable then we would recommend that the serious omission of the package--the lack of recognition of the needs of new and small businesses--be inserted. One avenue available would be to use the system of accelerated capital cost allowance advocated by the Royal Commission on Taxation.

APPENDIX

Effects of the Elimination of the Dual Rate of Corporate Taxation.

In the text of our Submission, the probable effects of the proposed system of taxation of business income were discussed, and policy implications examined and assessed. Data availability and limitations have forced us to examine the impact of the proposals dealing with the taxation of business income in a more cursory manner than we would have preferred. Unsuccessful attempts were made to obtain some of the background work which culminated in the revenue estimates in the Proposals for Tax Reform.

Some of the specific data requirements which would give a precise picture of the proposals affecting businesses in the Atlantic region include: cross-classifications of business income by income size, industrial classifications and province; assumptions made concerning business owner and/or shareholders of closely-held corporations; the amount of retained earnings used for capital expansion and the method of distributing profits.

Due to these limitations, it has become necessary to isolate the impact of the elimination of the dual rate of corporate income tax without taking account of the other proposals. We must, however, again state that we do not feel the compensations proposed in the White Paper are sufficient.

Methodology:

It was possible to ascertain from data released by the Department of Finance the distribution by size and number of firms allo-

<u>Appendix</u> continued

cating taxable income to the Atlantic Provinces in 1967. Thus, the effect of the implementation of the proposals which would eliminate the dual rate was quantified. However, it should be noted that it was not possible to take account of the impact of the other proposals, particularly the partnership option.

Table 1

Allocation of Taxable Corporations.
Atlantic Provinces in 1967 by
Range of Taxable Income

	$1-$1,999	$2,000-$4,999	$5,000-$9,999	$10,000-$19,999	$20,000-$34,999	$35,000+
Nfld.	133	131	130	169	159	132
P.E.I.	54	49	46	57	46	28
N.S.	443	400	406	368	296	176
N.B.	310	238	272	284	256	125

Source: Background Papers Submitted to the House of Commons Committee on Finance, Trade and Economic Affairs, by the Department of Finance.

Table 2

Estimated Taxable Income and Tax Payable
by Range of Taxable Income,
Atlantic Provinces, 1967

	$1-$1,999	$2,000-$4,999	$5,000-$9,999	$10,000-$19,999	$20,000-$34,999	$35,000+
			Taxable Income - thousands of dollars -			
Nfld.	117	442	935	2,454	4,570	38,370
P.E.I.	52	164	346	817	1,339	6,634
N.S.	375	1,349	2,945	5,356	8,511	69,748
N.B.	273	798	1,987	4,170	7,441	56,627
			Tax Payable Under Existing Legislation - dollars -			
Nfld.	24,570	92,820	196,350	515,340	959,700	17,845,200
P.E.I.	10,920	34,440	72,660	171,570	281,190	3,032,800
N.S.	78,750	283,290	618,450	1,124,760	1,787,310	33,087,600
N.B.	57,330	167,580	417,270	875,700	1,562,610	27,044,750
			Tax Payable Under Proposals for Tax Reform - dollars -			
Nfld.	58,500	221,000	467,500	1,227,000	2,285,000	19,185,000
P.E.I.	26,000	82,000	173,000	408,500	669,500	3,317,000
N.S.	187,500	674,500	1,472,500	2,678,000	4,255,500	34,874,000
N.B.	136,500	399,000	993,500	2,085,000	3,720,500	28,313,500

Source: Background Papers Submitted to the House of Commons Committee on Finance, Trade and Economic Affairs, by the Department of Finance.

Table 3

Increased Tax Burden as a Result of Elimination of Dual Corporate Rate, Atlantic Provinces, 1967

- dollars -

Nfld.	3,810,020
P.E.I.	1,072,420
N.S.	7,161,840
N.B.	5,522,760

Source: Background Papers Submitted to the House of Commons Committee on Finance, Trade and Economic Affairs, by the Department of Finance.

APPENDIX "F"

A

Submission Respecting

PROPOSALS FOR TAX REFORM

As Tabled in the House of Commons

Friday, November 7th, 1969

which is

Jointly Entered by

THE CO-OPERATIVE UNION OF CANADA

and

LE CONSEIL CANADIEN DE LA COOPERATION

INDEX AND SUMMARY OF PRINCIPAL POINTS

1. Identification of Organizations Making Presentation.
   Support of Other Organization

2. Purpose of Submission
   --Outline present provisions respecting co-operative taxation
   --Analyse White Paper proposal regarding co-operative taxation and demonstrate its unworkable character
   --Propose recommended proposal

3. Present Taxation Provisions
   --Non-income producing co-operatives
   --exempt co-operatives
   -- deductions permitted in calculating taxable income - conditions and limits of deductions

4. Nature of a Co-operative
   --Operated for people who use its service
   --Owned and financed by the people using its services
   --Democratically controlled by its owner-user-members
   --Distribution by patronage refunds

Analysis of White Paper Proposal

5. Criticism of Proposal
   --Fails to recognize the essential nature and method of operation.
   --Removes the right of many co-operatives to conduct affairs in a co-operative manner.
   --Proposal while not increasing tax revenue will cause great difficulties for co-operatives.
   --Proposal is illogical insertion into the general plan developed for taxing corporate income.

6. Description of Proposal
--Contained in paragraphs 4.68 to 4.71
--Proposal provides that co-operatives may distribute savings as patronage refunds provided it firstly pays a required return on capital employed.

7. Elements of Proposal Requiring Return on Capital Employed
--Meaning of capital employed uncertain must refer to return on either:
(a) the net equity of co-operative
(b) member investment in co-operative.

Net Equity of Co-operative includes
--Common shares or member loans
--Preference shares
--Reserves

Common Shares or Member Loans in Capital Employed
--Common share or member loan investment arises in co-operative substantially by re-investment of patronage refunds.
--Provincial legislation and co-operative structures prohibits paying the rate of return proposal requires.
--Common shares and member loans basically same thing and are similar to a type of deposit. They are repaid if member no longer uses services of co-operative.
--No capital gain on co-operative shares.
--Shares and loans made available to co-operatives not to produce a return but to enable co-operative to provide services.
--Investment in co-operatives made over period of years. Proposal ignores this and deems all investments at current lending rates.

Preference Shares in Capital Employed

--Preference shares have a fixed rate of return and often fixed maturity date; it is illogical to deem such investments to earn a higher or different rate of return.

Reserves in Capital Employed

--To include reserves in capital employed and using this as a tax base requires a continued tax payment on tax paid items.

--To include reserves in any capital employed formula and requiring a return to be paid on these amounts must of necessity increase the rate of return payable on common shares or member loans. However, the return which can be paid on common shares and member loans is limited by regulations hence this return cannot legally be paid.

Member Investment as Capital Employed

--To require a deemed return on member investment ignores the principles of operation of a co-operative which is that member investment is made to enable the co-operative to provide services to it and not to produce a return on its own right.

--It would tend to eliminate the right of co-operatives to distribute their surplus earning as patronage refunds.

Objections to Capital Employed and Deemed Rate of Return Concept

(a) such a concept ignores the nature of co-operative capital which continues to revolve and be redeemed.

(b) the rate of interest proposed would effectively prohibit patronage refunds.

(c) the concept is difficult to define and more difficult to comply with.

(d) the proposal is illogical and does not fit into an integrated tax system.

(e) the proposal would appear to create extensive legal compliance problems.

10. Creditable Tax Integration Problems Under Proposal

--Must have some formula since tax may be paid under proposal.

--Co-operatives must be able to integrate tax either with patronage refunds or with interest or dividends on shares or loans.

--Must have total integration.

11. Co-operatives and Proposed Corporate Treatment

(a) Partnership Election

--many similar features

--main difficulty is impracticality of all co-operatives having same year end.

(b) Closely-Held Designation

--corporate operations and distributions different in nature to those of co-operatives.

--capital structures of co-operatives and corporations not similar.

--method of any form of passing on creditable tax difficult because of co-operative patronage refunds.

(c) Widely-held Designation

--co-operatives Canadian owned.

--co-operatives have high degree of personal involvement.

--co-operative stock no capital gain and not listed on stock exchange.

Co-operative Proposal

12. Proposal

--That co-operatives be permitted to deduct all distributions, whether made by way of a return on member investment or as a patronage refund, with all surplus not distributed being taxed to the co-operative at a collective rate of tax.

13. --Provides for direct transfer of co-operative surplus earnings to its members to be dealt with by them in dealing with their income.

14. --Provides for taxation of income once

15. --Provides co-operative to be able to eliminate income as proposed by White Paper.

16. --Recognizes essential co-operative nature.

17. --Income not distributed taxed at collective individual provincial rates as undistributed earnings collectively owned.

18. --No integration of taxes paid by co-operative.

19. --Reserves if ever paid out taxed at full personal rates.

20. --Consumer Patronage Refunds to continue to be exempt from taxation in individual hands:
 -amount minimal
 -result from expenses directly relating to cost of living.

23. Conclusion

--There is to be created a third category for tax treatment Co-operatively-held Corporations

24. Elimination of Three Year Tax Exemption
--Acceptable but has been of valuable service in past.

25. Meeting Costs
--Should continue to be deductible.

A

Submission Respecting

PROPOSALS FOR TAX REFORM

As Tabled in the House of Commons

Friday, November 7th, 1969

which is

Jointly Entered by

THE CO-OPERATIVE UNION OF CANADA

and

LE CONSEIL CANADIEN DE LA COOPERATION

INTRODUCTION

This submission is being presented jointly by the Co-operative Union of Canada, Ottawa, and Le Conseil Canadien de la Cooperation, Quebec City. The representation made herein represents the views, of the national, regional and provincial co-operatives operating throughout Canada.

Together, the Co-operative Union of Canada and Le Conseil Canadien de la Cooperation represent a very substantial majority of Canadian co-operatives. "Co-operation in Canada, 1967" published by the Economics Branch, Canada Department of Agriculture, published in 1969 offers the following information respecting the number of co-operatives

and members:

Type of Co-operative	Number of Organizations	Number of Members
Marketing & Purchasing	1,357	1,364,000
Production	380	30,000
Fishermen's	86	9,000
Services	696	285,000
	2,519	1,688,000

While this submission is being made principally on behalf of the Co-operative Union of Canada and Le Conseil Canadien de la Cooperation it has also been approved by La Federation De Quebec Des Unions Regionales Des Caisses Populaires Desjardins as to the suggested approach for the taxation of co-operative activities.

La Federation De Quebec Des Unions Regionales Des Caisses Populaires Desjardins will be presenting a supplemental submission concurrently with this submission. It is the desire of the participating organizations to provide a full expression of Canadian co-operative opinion without undue repetition.

While as is the case with other citizens of Canada

Le Conseil Canadien de la Cooperation and the Co-operative Union of Canada and their members have views on many aspects of the proposed tax reforms. Nevertheless it is intended in this submission to deal only with that proposal specifically designed for "Co-operative Taxation", namely paragraphs 4.68 to 4.71 inclusive. These paragraphs are generally referred to in this submission as the "White Paper" proposal.

PURPOSE OF SUBMISSION

The purpose of this submission is three-fold.

1. To outline the present taxation provisions respecting co-operatives.

2. To analyze in detail the suggested White Paper tax reform proposal developed for the taxation of co-operatives and their members and to demonstrate that the same is not workable generally for the following reasons:

    (a) It is not a logical inclusion in an otherwise economically logical program for the taxation of corporate endeavours.

    (b) It is difficult to define.

    (c) It is difficult to comply with:

        (i) contrary to the philosophy of co-operatives.

        (ii) contrary to the regulations governing co-operative operations.

(d) It fails to recognize the revolving nature of co-operative capital.

3. To suggest a proposal for the taxation of the surplus earnings resulting from co-operative operations in a manner consistent with the financial practices of Canadian co-operatives and consistent with the principles of the general reform proposals of the White Paper.

PART I

PRESENT TAXATION PROVISION OF CO-OPERATIVE OPERATIONS

There are three specific areas of concern in outlining the present taxation of co-operative operations that must be considered:

1. Has the association any income at all.
2. Is the income of the association exempt.
3. What deductions can be made from the net surplus earnings of an association to determine taxable income.

These points will be dealt with briefly to provide to the reader an appreciation of the present provisions of The Income Tax Act.

1. Has the Association any Income at All

Non-income co-operatives are those whose surplus

earnings are not as a matter of law, property of the co-operative. These co-operatives are frequently referred to as "agency co-operatives". The test as to whether an amount received by a taxpayer has the quality of income has in one taxation case been put in question form as follows:

> "Is his right to it absolute and under no restriction, contractual or otherwise, as to its disposition, use or enjoyment?"

2. Is the Income of the Association Exempt

(a) Section 73 of The Income Tax Act provides that no tax is payable by a co-operative upon any taxable income for each of its first three years of operation, if it meets certain restrictions of operation, which would basically require it to be an operation of local nature only.

(b) Section 62(1)(k) provides that no tax is payable upon any taxable income of Credit Unions and Caisses Populaires which operate in one province and derive their surplus earnings primarily from dealing with their members.

3. What Deductions may be made from Net Surplus Earnings to determine Taxable Income

Section 75 provides that all co-operatives and any other corporations may deduct any amount paid or credited to their members on a patronage basis. Subject

to a number of conditions and limits:

(a) Prior to the commencement of the fiscal period there must have been held forth the prospect of the patronage allocation:

(b) The patronage allocation must be computed and paid in relation to the business done:

(c) All recipients of patronage allocations are to receive the same rate, provided that if payment is not made to non-members of the co-operative, the co-operative can only pass to members the surplus earnings derived from member business.

(d) Payment of the patronage refund must be made within the taxation year or twelve months thereafter.

The limits imposed below which a co-operative may not reduce its surplus earnings through the making of patronage refunds are as follows:

(a) The surplus earnings may not be reduced below a figure equal to 3% of capital employed less the interest paid on loans other than loans to banks, Credit Unions and Caisses Populaires.

(b) The income earned on non-member business that is not distributed to non-members may not be deducted from taxable income.

(c) The amount of unallocated reserves.

Thus a co-operative presently may not reduce its income by way of paying patronage refunds below the greater of 3% of capital employed, income from non-member business or the amount of reserves.

Taxation of Co-operative Distributions

Except for allocations of patronage refunds in respect of consumer goods and services, dividends received by a customer of a co-operative must be included in computing his income.

Amounts received by members of a co-operative on his investment in the co-operative are included in his income. If the payment is in the form of dividends on shares the usual 20% dividend tax credit will be available to the recipient.

PART II

NATURE OF A CO-OPERATIVE

In order to analyze the proposal relating to "Co-operative Taxation", co-operative methods of operation must be understood. It appears that in drafting the proposals that the essential nature and method of operation of a co-operative and the essential difference in its purpose and in its capital structure from that of an ordinary corporation

has either been given little or no attention or has not been understood, perhaps from lack of information available to those drafting the proposal. Consequently, at the outset of this submission it is intended to discuss briefly the essential nature of a co-operative.

1. A co-operative is created and exists for the purpose of providing services or goods to its members, with membership in the co-operative being generally available to all persons who can use it.

2. Surplus earnings arising from the business of the co-operative belong to the members and are distributed on a regular basis to the members of the co-operative in relation to the volume of business which each member has done with or through the co-operative.

3. A part or all of such savings allocated to each member may be re-invested in the co-operative, not to produce a return but rather to make possible further and better services.

4. Member investment in a co-operative constantly revolves. The investment by a member is similar to a temporary deposit to enable the co-operative to provide him with services. There is experienced by co-operatives a gradual withdrawal of capital loaned in earlier periods to be replaced by new capital

loans by current members.

5. There is often no return paid on member investment in the co-operative, where such a return is paid it is restricted by statute or by-law and by co-operative practice to a low rate of return.

6. Voting in a co-operative is restricted to essentially one vote per member, regardless of the extent or nature of the investment by the member in the co-operative.

7. Capital gain on a member's investment in an operating co-operative is non-existent.

It must be recognized that the flow of funds in a co-operative resulting from business operations is by way of a return to members in relation to the business done by them with or through the co-operative. This is best described as an additional payment for goods sold for him, or as a refund in respect of the charge made for goods sold to him or as a refund in respect of a charge levied for services provided. Thus there is in a co-operative no relation between the member's investment in a co-operative and the return made to him. A member with a $1.00 investment may receive a return of $10.00 and a member with a $10.00 investment may receive no return, in each case depending upon the amount of business done by each with the co-operative during the period involved. Further, the member with the $1.00 investment has the same governmental voting rights as the member with the $10.00

investment.

It is an accepted principle that a member of a co-operative wishing to remove some or all of his investment from the co-operative, either while continuing to use its services or upon terminating his membership will receive only the amount of his investment with no capital gain. Even on the dissolution of a co-operative members generally receive back only the amount of their investment, again with no capital gain.

The foregoing discussion, confirmed by the principles of co-operation approved recently by the International Co-operative Alliance (set forth in Schedule "A" hereof) illustrates the essential "collectivity" (or common purpose) of a co-operative.

Co-operatives wish to emphasize that in submissions that have been from time to time made to various bodies studying the taxation of the distribution of surplus earnings by co-operatives that there has been stressed the necessity of recognizing the nature of co-operatives, their methods of financing and the ownership and the method of distribution of the co-operative's surplus earnings. In brief all that co-operatives have asked and are asking is that they be recognized for what they are and to be treated as such.

PART III

ANALYSIS OF WHITE PAPER PROPOSALS

A. CRITICISM OF PROPOSAL

It is presumed that the motivation in drafting the proposal with respect to "Co-operative Taxation" was solely that of designing a taxation device consistent with the stated aim of the White Paper, to achieve equity among taxpayers who participate in the benefit of corporate activity, having regard to the differing relationships between corporations and their shareholders (or members).

In view of this it is amazing and in fact alarming that the proposal relating to co-operatives attempts to direct how co-operatives, a substantial segment of the Canadian economy, are to distribute their annual surplus earnings. In keeping with the general White Paper economic principles it would seem to have been satisfactory to provide that distributions to members by a co-operative should be taken into the income of the recipient with any earnings not distributed to be taxed in the hands of the co-operative. Co-operatives appreciate that the proposal does provide that the net surplus earnings of a co-operative may be distributed to their members. however, the proposal directs to co-operatives how they must make these distributions in order to reduce their taxable income.

Because the proposal, if applied to co-operatives would

not appear to have been designed to raise any more tax revenue, it seems reasonable to question the logic in directing the form that these distributions must take. In many cases the proposal effectively prevents co-operatives from continuing to distribute their surplus earnings as a co-operative.

It will thus be readily apparent that the manner of direction in the proposal is not only unnecessary but could be considered an alarming development in a public taxing statute. In addition, to ignoring the nature of a co-operative it is felt that the White Paper proposal will have the effect of shortly destroying many co-operatives now providing much needed local services and facilities.

Co-operatives and their members appreciate that tax revenues must be secured by the Government of Canada. It must, however, be constantly kept in mind that what is being looked at in the proposed taxation device is the taxation of a taxpayer as distinct from the taxation of an economic asset in itself. In other words, what is being taxed is the economic benefit achieved by a taxpayer. In a co-operative the economic benefit belongs to the member and is distributed to him by way of a return in relation to the business relationships he had had with the co-operative, and it is in the hands of the recipient as a taxpayer that the economic benefit is considered for tax purposes.

It should be pointed out that most co-operative distributions are presently taken directly by the recipient into income or are treated by him as a reduction of his business expense so as to increase his net annual income. Annually many millions of dollars of additional income are included in the income tax returns of members of co-operatives by reason of co-operative distributions. From the tables published in 1969 by the Canada Department of Agriculture for co-operative activity (exclusive of any Credit Union or Caisses Populaires operations) in Canada for the year 1967 it can be concluded that out of a total volume of business of 2,179.4 millions of dollars some 90% of this business related to producer types of business, the savings from which is taken directly by the recipient into his income.

It seems illogical that in developing a new system of taxation based on a logical tax treatment of corporate income that there should have been inserted a provision which is nothing more than the acceptance and the aggravation of a taxation device never developed from logic but which was developed as a result of a political compromise only. This point is referred to as early as 1962 by R.C. McIvor in his book Recent Growth in Canadian Co-operatives, prepared for the Canadian Tax Foundation. At page 34 he states:

> "This provision was nowhere recommended in the Commission's report (1945 Royal Commission) and it appears to have been enacted after representations made from the competitors of the co-operatives as a typical political compromise.

> This being so, it is difficult to defend in principle the present proposal that minimum taxable income be raised, say to six percent, in conformity with current long term interest rates. One may concede that capital employed in industry is productive, i.e., it yields a net return, but so does labour, and other resources. It does not therefore follow that enterprise should be taxed on the basis of capital employed or wages paid or on other components of cost. If the taxation of co-operatives is deemed by competitors to be inequitable the remedy may be sought more rationally elsewhere."

It should also be recognized that the Carter Royal Commission did not recommend any capital employed concept in the tax treatment of co-operative distributions.

Perhaps as a concluding comment it should be pointed out that co-operatives now form a substantial part of the Canadian economic life, serving approximately 1/10th of the Canadian population in many varied ways according to their needs and in conformity with their means. It is unsound that a taxation statute should destroy the foundation of such enterprises.

While criticism is expressed as to the proposal affecting the distribution of co-operative surplus, co-operatives do support the concept of taxation of sources of income in the hands of the individual and at his rates. This is the principle the co-operatives wish to have applied to themselves and their members as well.

B. PROPOSAL

The proposal respecting the proposed future taxation of co-

operatives is set forth in paragraphs 4.68 to 4.71 with the effective portion contained in paragraphs 4.70 and 4.71.

Because of the brevity of these statements they are reproduced here in total.

> "4.70 The government proposes that the interest rate be set in accordance with a formula comparable to the formula used to determine the rate on farm improvement loans -- that is, the rate would vary from year to year depending upon the interest rates paid on government bonds. It is also proposed that only interest paid to members on their loans and capital be taken into account after the deduction of patronage dividends."

> "4.71 As a result, co-operatives could continue to eliminate taxable income by a combination of patronage dividends and interest to members. However, members would be taxable on a full commercial rate of interest on the investment which they have in the co-operative (provided of course the co-operative earns that much before patronage dividends)."

In short, the proposal provides that a co-operative may distribute its entire surplus earnings to members. However, the proposal provides that only a limited portion may be distributed in the form of patronage refunds. That is, the sum returned as patronage refunds is limited by the requirement that the co-operative provide to its members a return on their capital investment. The rate of return on the capital investment would be that resulting when the sum of "capital employed" is multiplied by the current rate of interest on farm improvement loans. The co-operative may then distribute to its members this return on member capital investment and end up with no

taxable income.

It is important to appreciate that the proposal accords the option to eliminate (distribute) the total of its surplus earnings provided it is distributed in the set pattern.

Insofar as the distributions made by the co-operative are concerned all payments made to members, as a return on their member investment, whether by way of interest or dividend will be taken into income by the recipient. Also all patronage refunds, which can be classed as producer patronage refunds, which as is stated before form the bulk of all patronage refunds, are again taken in to income by the recipient. The proposal would appear to continue the exemption of consumer patronage refunds.

C. ELEMENTS OF THE PROPOSAL

1. CAPITAL EMPLOYED

In attempting to apply the White Paper proposals the first problem to be resolved is the meaning of the words "capital employed". As is stated before, the concept of capital employed is used to determine the maximum patronage refunds which may be deducted from the surplus earnings of the co-operative.

There would appear to be two possible definitions which may be given to the words "capital employed":

(a) The net equity of a co-operative: or

(b) Member Investment.

Substantial differences will result from the proposal from the use of the net equity concept, which is basically the capital of the co-operative as distinct from member investment which refers to the members' personal contributions to the capital of the co-operative. It is therefore necessary to examine these two concepts in detail.

(a) Net Equity

The elements of a co-operative corporate structure which would form its net equity are:

(i) member loans or common shares

(ii) preference shares

(iii) reserves

Member Loans or Common Shares

The general pattern of acquiring member loans or obtaining member investment in common shares has already been referred to. A nominal fee is accepted at the time of becoming a member and the member then increases his investment by depositing all or a part of his annual patronage refund with the co-operative, with or without an agreed rate of return to be paid thereon. This deposit of funds may be in the form of member loans or by the acquisition of shares. Thus a member will have an investment in the co-operative built up over a period of years.

It will thus be apparent that the

co-operative corporate entity has obtained member capital (loans or shares) at various money rates. To now speak of a return at current money rates does not take cognizance of this fact.

Perhaps the greatest difficulty with respect to applying the White Paper proposal to member loans or common shares is the regulation applying to all co-operatives, either by statute or by-law, restricting the rate of return which a co-operative may pay on this type of investment. It is worthy of comment to note that provincial legislation has recognized this principle of co-operative operations and has legislated maximum returns. The White Paper proposal has in disregard of this principle proposed minimum returns and in excess of the maximum regulations.

It seems that the White Paper proposal failed to recognize this co-operative principle and the practical fact that co-operatives are prohibited from paying the minimum returns required.

If a co-operative wished to utilize

the provisions of the proposal to eliminate taxable income, great administrative difficulties would be experienced in the allocation of returns on many minimal investments. Co-operatives by their nature tend to have many members who each individually will have only a small investment in their co-operative. Even at 8½% as the required rate, this will require investment of approximately $12.00 to get a return of $1.00. Many individual members have an investment less than this.

A clear distinction must be made and understood as to the types of member loans which form part of member equity. The only loans included are thosemade as a member. Members may temporarily deposit funds with a co-operative through some form of bonds, savings certificates or on a demand basis. Such loans to a co-operative should be eliminated as they are mere borrowings, unrelated to membership requirements.

Preference Shares in Net Equity

Preference shares in a co-operative consist of either invested patronage refunds (similar to member loans), or general financing shares issued to secure additional

capital funds. Regardless of the manner of creation these preference shares will bear a fixed rate of return and are often issued with a fixed redemption date. It is illogical to include these in a capital employed formula, and compute thereon a rate of return different than the rate of return which they bear as a fixed rate of return. The extent of the seriousness of this problem is demonstrated later in discussing the element of reserves as part of capital employed.

The uncertainty of the application of the White Paper proposal is increased if, however, all equity investments bearing a fixed rate of return are excluded from any imposed capital employed concept. Should a method of passing on creditable tax be devised for corporations securing this type of investment co-operatives may well be prejudiced should they have similar investments and not be in a position to pass on creditable tax to the holders of their investments of this type.

Because of the uncertainty created

by the White Paper proposal, if a capital employed formula is implemented then co-operatives must be given the election to include or exclude from any such formula some or all of the investments issued by it bearing a fixed rate of return.

It should be pointed out here that consistent amendments must be made to the Income Tax Act to enable all returns (interest or dividends) paid on member investment to be deductible from the surplus earnings of the co-operative, if the proposals of the White Paper are to be capable of being accomplished; presently dividends are not deductible.

Reserves in Net Equity

Reserves in a co-operative result either from undistributed surplus earnings or from a re-evaluation of assets.

To include reserves as an element of capital employed is both objectionable in itself and must of necessity create serious problems if a current market rate of return is deemed to have been created by it.

As is known, reserve calculations are a very fluctuating capital element

depending, to a large degree, on the accounting principles used. The inclusion of reserves in a capital employed formula could well force undesirable write-offs and adjustments to the value of fixed assets and investments and possibly the elimination of contingency-type reserves in order not to attract continued taxation.

It must also be recognized that many operating co-operatives must annually create non-discretionary reserves to comply with the statutory requirements regulating its operation. Thus they must, without any discretion, annually increase this factor of capital employed.

Co-operatives object to using such a variable concept as reserves as a factor in determining a base to set a limit on patronage refunds.

The principle of using tax paid reserves as a factor in determining what could be a co-operative's continuing tax requirement is in total disagreement with the general philosophy of the White Paper tax proposals. For those co-operatives

with re-evaluation reserves this proposal would now be an effective retroactive tax collected on an annual basis. In the case of La Cooperative Federee de Quebec these re-evaluation reserves are in the approximate amount of 3.8 million dollars. The amount of return that could be required to be paid on these reserves is substantial.

Perhaps the greatest objection to the use of reserves as a part of capital employed, and an illustration of the illogical development of the whole concept, is the effect which the inclusion of reserves will have on the deemed return imputed to accrue on member investment.

It must be acknowledged that if the principle of the proposal is to be achieved, the computed deemed return must be able to be distributed among the members of the co-operative. Calculations have indicated that this cannot be done. A few examples will show why this is so.

In the case of United Co-operatives of Ontario, using a combination of common shares, preference shares and reserves, a total net equity of approximately $10.5 million is arrived at. If a current rate

of $8\frac{1}{2}\%$ is used as the applicable interest rate, and recognizing that the issued preference shares of approximately $3.5 million bear a fixed rate of return, to distribute the deemed return calculated on the total net equity being common shares, preference shares and reserves a return of in excess of <u>21%</u> would need to be paid on common shares to equal this rate of return on capital employed. This rate in the case of Maritime Co-operative Services Limited would be in excess of <u>27%</u>.

Of course, limits exist as to the returns, both by practice and by regulations, which may be paid by these two co-operatives. Many similar Canadian examples exist and would indicate that the problem is substantial for many co-operatives. It also demonstrates how the proposal has lost sight of the methods of financing and operation of co-operatives and perhaps even of their basic purpose.

It will, of course, be obvious that if reserves became part of a capital employed formula that any co-operative with an accumulated deficit must be able to use

such a deficit as a negative type of reserve in the calculation of capital employed.

(b) Member Investment as Capital Employed

In the preceeding section the concept of capital employed being defined as net equity was discussed. It is now necessary to discuss the possibility of capital employed being defined as member equity since the White Paper proposal refers to both concepts.

At the outset the concept of member investment must be understood. Member investment in the capital of a co-operative is that contribution made by a member as a member, normally in the form of an initial capital contribution and subsequent deposits or re-investment of patronage refunds paid to him by the co-operative. Monies made available in the form of ordinary loans do not form part of member investment for capital purposes.

There are a number of objections which may be made to the proposition of deeming a return to be earned by member investment.

(i) Such a proposition ignores the essential difference in the nature of co-operative distributions and attempts to treat all corporate entities alike, whether co-operative or

corporation, and whether distributing surplus earnings as a patronage refund, according to business done, or as a return on investment as in an ordinary corporation.

(ii) Such a proposition ignores the essential difference between the capital of a co-operative and an ordinary corporation since in a co-operative member investment is to produce savings in the business dealings done by the member with the co-operative rather than to produce a return in its own right.

Some of the administrative problems which will be encountered in requiring a deemed return on member investment are as follows:

(i) Legal maximum limits exist limiting the maximum interest or dividends which may be paid on member investment.

(ii) Numerous minimal member investments.

(iii) Member investment will fluctuate each year due to repayment of all or a part of a member's equity during the year.

(iv) In any capital employed formula the path to pass on creditable tax for integration purposes of any tax payments made by the

co-operative is very obscure.

PART IV

OBJECTIONS TO A CAPITAL EMPLOYED AND DEEMED RATE OF RETURN CONCEPT

Reference has already been made to the historical political compromise in the development of the capital employed concept for the taxation of co-operatives and of the difficulties in understanding this concept and applying it in an otherwise logically developed approach for the taxation of corporate income.

Co-operatives have always objected to a taxation formula using a capital employed concept to determine the maximum patronage refunds which they may make in the process of distributing their surplus earnings to their members.

1. Unless the surplus earnings of the co-operative is in excess of the deemed rate of return it will be forced to operate its member-co-operative relations as any other corporation . The relatively high interest rate intended to be applied would have the effect of allowing little if any surplus earnings to be allocated to patronage refunds. This of course prohibits members from operating a co-operative form of enterprise since it would require distributions to be substantially all

in the ordinary corporate form, namely a return on capital.

2. Imposing a deemed rate of return is an unwarranted and illogical intrusion by a taxing statute in the affairs of a body corporate, attempting to regulate the relationship of the body corporate with its members in a manner and in an area of relationship which has little, if any, tax consequence.

Co-operatives object to the concept that in a collective type of operation such as a co-operative, that as a first condition to the returning of surplus earnings to their members, there must be paid or distributed toward member investment a full commercial rate of return even if they have collectively determined to distribute savings according to patronage. At the very least the creators of these surplus earnings, namely those who have done business with the co-operative, have an equal claim to these surplus earnings as do the members who have contributed the capital.

Co-operative members have, however, agreed that the members creating the surplus earnings of the co-operative by their business with the co-operative should be entitled to these surplus earnings. They object to a taxation device refusing them the right to

make this decision.

3. Co-operative capital is by its nature very "fluid". It can be understood to be a deposit by a member to be used by the co-operative to provide him with services while he is a member and then to be refunded. The extent of the annual withdrawal of capital is approximately 5% to 10% of the capital invested in the co-operative, which requires a disbursement of approximately 50% of the annual surplus earnings of the co-operative.

If the co-operative has a surplus earning of an amount less than the deemed rate of return and if it either by choice or because of its regulations does not pay this required return on its member equity, it may well face financial difficulties or even financial insolvency if it is required to pay a corporate rate of tax on its surplus earnings and its repurchase of member equity requirement exceeds the then 50% of the surplus earnings remaining in the co-operative. An example to illustrate what may result in this manner is set forth in Schedule "B" attached hereto.

Because a substantial part of member investment capital results from a re-investment of patronage refunds, a proposal such as that proposed may seriously restrict or may even delete this source of investment capital. This may well place co-operatives in financial difficulties. It will, of course, be recognized that as there is experienced a retirement

of earlier member investments, there will be a continued shrinkage of the net equity of the co-operative unless further member investment is received.

4. Farm Improvement Loan rates generally change twice a year. This of necessity would create not only administrative difficulties but in addition creates grave uncertainties in the co-operative as to its actual deemed rate of return for any fiscal period.

5. The definition of capital employed will be difficult to specify and administer.

6. The extensive capital fluctuations during a fiscal period will create further administrative difficulties.

7. It is difficult to rationalize a deemed current economic rate being imposed which ignores the fact of capital accumulation over a period of years.

8. Because co-operatives are restricted by regulations as to the maximum returns (interest or dividends) which can be paid on member investment, and with the deemed rate set as high as it is, tax will have to be paid by the co-operative which will create the administrative problem of passing on minimal amounts of creditable tax and consequent applications for refunds. In this connection it should be mentioned that many members of co-operatives are not in a taxable income category. This will increase with the proposed increased personal

exemptions.

9. A review of tax case reporting services will indicate very little litigation between co-operatives and the Crown in the field of taxation . However, if the White Paper proposal is adopted a great increase in litigation may result. Co-operative legislation and co-operative regulations strictly limit the portion of the surplus earnings of the co-operative which may be disbursed in a discretionary manner. Co-operatives are then required to return the balance of the surplus earnings to their members in accordance with the business done by each member with the co-operative.

Extensive legal jurisprudence has been developed in this matter in the United States and the American courts have drawn a distinction between a deduction from income and an exclusion from income. In short, it would appear that where a corporate entity has no discretion as to the disposal of certain funds these funds are excluded from its income.

This principle, while not as fully developed in our legal jurisprudence, nevertheless has been applied in Canada (Vide Canadian Fruit Distributors Limited vs. M.W.R. 54 D.T.C. 1145).

It is hoped that this problem will be understood and avoided.

PART V

CO-OPERATIVES AND CREDITABLE TAX INTEGRATION

The basic principle running through the White Paper tax reform proposals is that income should be taxed once and at the personal rate of the recipient whether such income is received directly or as a corporate distribution.

No method of corporate distribution more directly passes corporate surplus earnings into the hands of the recipient, to be dealt with by him in his income than does the method of patronage refunds.

However, when considering the White Paper proposal respecting co-operatives there will of necessity be taxes paid by co-operatives since co-operatives must set up statutory reserves and further since they cannot pay the proposed rate of return. Thus a system of passing on this creditable tax must be devised.

In principle the creditable tax should flow along with any return paid on member investment. This, however, would pose an unreasonable restriction on co-operatives. A co-operative may elect to pay no return on member investment in which case the only distribution path is patronage refunds. Also, the legal restrictions under which it is operating may

prevent it from paying sufficient return to pass on all the creditable tax. In this case all or a part of the creditable tax must pass along with patronage refunds.

Thus, if a co-operative, as a corporate entity, has paid tax and has built up creditable tax, it must be able to elect the procedure for passing on this creditable tax which will be either:

in relation to member investment: or

in relation to patronage refunds

Creditable tax passed along with patronage refunds will have to be a calculated percentage applicable to such refunds to provide for the total passing on of this creditable tax. The percentage rate used will vary from co-operative to co-operative depending on the amount of creditable tax and depending on the amount of patronage refunds paid.

It will be necessary, if the White Paper proposals respecting "Co-operative Taxation" are implemented to provide for the ability for a co-operative to pass on the total of its creditable tax to ensure that double taxation does not occur.

PART VI

CO-OPERATIVES AND CORPORATE TAX TREATMENT

It is felt that the discussion to this point has demonstrated that the White Paper proposal for the taxation

of co-operatives will not work and should not be implemented by legislation.

It is therefore necessary to consider the applicability of the proposals devised for the taxation of the income of corporations to determine if any of these methods would be equitable if applied to co-operatives "having in mind the differing relationships between corporations and their shareholders (members)".

A. CORPORATIONS ELECTING TREATMENT AS A PARTNERSHIP

It is recognized that the transmission of co-operative earned surplus to member patrons bears some similarity to a corporation electing the partnership method of allocating earned surplus to its shareholders.

The requirements for this election would appear to be:

1. Signed agreement by all members;
2. Method of distribution clear;
3. Members all Canadians;
4. Any corporate member to have same year end.

While it is theoretically possible to get the signatures of all members of a co-operative, in some co-operatives this would present a problem because of the numbers involved.

In a co-operative the method of distribution is known. However, it is based on the principle of patronage refunds in

relation to the volume of business done by the member rather than the investment of a member, which seems to be the principle in developing this proposal. Also, while the method is known the percentage of the earned surplus which will be allocated to each patron member will vary each year, again depending on the volume of business done by that member with the co-operative during that year.

Co-operatives could comply with the Canadian content requirement.

It would appear impractical, if not impossible, to get all co-operative year ends the same. Many co-operatives, particularly agricultural co-operatives, have their year ends at times depending on the times of distribution of other enterprises in order to pass this distribution received, as quickly as possible, to their members. For example, the year ends of the Wheat Pools are "tied in" with the date selected for the closing of the books of the Canadian Wheat Board. Others are "tied into" the dates selected by other marketing boards. Because of the inter-relation of Canadian co-operatives it would not appear possible to achieve this election of a common year end for all co-operatives.

It would appear therefore, that this election is not available to co-operatives.

B. CLOSELY-HELD CORPORATION TREATMENT

In a comparison of a closely-held versus a widely-held designation, a co-operative must of necessity be treated,

by the very definition, as a closely-held corporation. However, the treatment of a co-operative as a corporation of any designation would certainly not result in an equitable treatment. The necessity for the recognition of the special form of co-operative distribution was accepted by the "McDougall Royal Commission" of 1945, the "Carter Royal Commission" of 1966 and again by the White Paper proposals.

Some of the reasons dictating this recognition of a separate treatment are as follows:

> The capital nature of a co-operative is essentially different from that of a corporation. Whether the investment of the co-operative member is in the form of a loan or is in shares the member capital contribution is more like a deposit than a capital contribution in a corporation. The capital structure of a co-operative is a "fluid" type of structure subject to constant fluctuations whereas the capital of a corporation tends to have a "locked-in" aspect keeping it available for the purposes of the company.
>
> This difference in capital structure must be provided for in any system of taxation which is to

be applied to co-operatives.

To treat a co-operative as a corporation for tax purposes ignores the nature and ownership of co-operatives distribution and the claim which the patron owners have to the surplus earnings.

Any treatment of a co-operative as a corporation for tax purposes would create the problem of numerous T-5 returns for small amounts (and the necessity of devising a formula for passing on creditable tax with patronage refunds). Because many of the recipients of co-operative distributions will not be taxable many claims for refunds will result from the election of this method of taxation.

C. WIDELY-HELD CORPORATION TREATMENT

Co-operatives by their very nature experience a high degree of personal member involvement. Each member--user has an opportunity to attend meetings of the co-operative and because of his affinity, has a closer personal interest in the management of the operations. This is substantially

different from the impersonal relationship in a widely-held corporation. In a co-operative the principle of personal relationship is again displayed in the manner of voting. Voting is on a personal rather than an investment basis with the principle being one member--one vote. This of course is substantially different than the situation in any corporation.

It will, of course, be recognized that co-operative shares by their very nature will not be listed on a stock exchange.

Also co-operatives are Canadian owned as distinct from the wide spread international ownership of many widely-held corporations.

It will be recognized that the designation of a corporation as a widely-held corporation gives to it a distinct advantage in that only one-half of the capital gain on its shares is taxable. (paragraph 4.41) However, in a co-operative the investor attraction with respect to capital gain is non-existant, hence if the benefits of a widely-held designation are not available surely the co-operative would not be so treated and experience the penalties, namely one-half creditable tax.

CORPORATE TAX TREATMENT DEVISED NOT APPLICABLE

In conclusion it can be fairly stated that the methods devised for corporate tax treatment were not designed for and are not adaptable to the co-operative form of business activity.

This of course was recognized by the draftsmen of the White Paper proposals who devised, albeit, a not satisfactory, but a specific formula for co-operatives.

Co-operatives are of the view that it is their duty to propose a system for the taxation of the net savings accruing from co-operative activity in keeping with the nature of co-operatives and in keeping with the White Paper generally.

PART VII

CO-OPERATIVE PROPOSAL

A. PROPOSAL

That co-operatives be permitted to deduct all distributions made whether by way of a return on member investment or as a patronage refund, in arriving at taxable income, with all surplus earnings not distributed being taxed to the co-operative at a collective rate of tax.

B. RATIONALE OF THE PROPOSAL

1. Simplicity.
2. The principle of the White Paper is to tax income once.
3. The White Paper proposes that co-operatives be able to eliminate income by transferring it to members.
4. It recognizes the essential characteristics of co-operatives.

5. Income not distributed would be taxed at collective rates.

C. DISCUSSION OF PROPOSAL

Simplicity

The proposal recognizes the essential nature and methods of operation of a co-operative. Distribution can be made in compliance with the statutes and by-laws regulating each co-operative. The application of this "conduit" principle to co-operatives' surplus earnings must be of great attraction to tax administrators. This proposal would provide for the early transfer to individual members the current surplus earnings of the co-operative to be dealt with by him in dealing with his personal income. It will eliminate the necessity of many tax credit transfers or refund claims being processed in respect of corporate income earned years previously as may be the case with ordinary corporations.

Principle of White Paper is to Tax Income Once

The acceptance of the basic integration concept of corporate and shareholder income has gone a long way to achieve the principle that persons having similar income should carry the same share of the tax load. Co-operatives wish to express their acceptance of this

proposition.

The co-operative proposed method accomplishes this in a straight-line relationship and provides for an early inclusion of co-operative surplus earnings in the hands of the member recipient for his personal tax treatment.

White Paper Proposal Proposes that Co-operatives be able to Eliminate all Income

In order to achieve this stated goal the mechanics must be practical and capable of being complied with. Most important the mechanics must provide for this to be done in keeping with the nature, methods of operation and the legal obligations of a co-operative. The co-operative proposal recognizes these features. The White Paper proposal will require substantial changes to many provincial co-operative Acts if any possibility of being able to comply is to exist.

It Recognizes the Essential Characteristics of a Co-operative

Paragraph 1.5 of the White Paper states that one of the main points to be met by the proposals is "corporations are taxed in ways that are open to abuse and that fail to recognize their differing relationships with shareholders".

Co-operatives are of the view that the White Paper proposal respecting co-operatives has failed to take adequate cognizance of the essential collectivity

of the purpose and capital of the co-operative. The co-operative principle of doing a collective form of business to produce savings should not be lost sight of.

Income not Distributed Would be Taxed at Collective Rates

This principle is that surplus earnings retained by the co-operative and set up as a reserve should be taxed at the average personal rate payable by its members. While this statement of this principle is in the ideal form it is recognized that a practical administrative statement would have to be that the undistributed surplus earnings of the co-operative should be taxed at the average provincial personal rate in the province in which the co-operative carries on business.

The underlying principles to this statement are:

(a) Co-operative reserves are collectively owned, with no or limited member entitlement.

(b) There would be no integration of the taxes paid by the co-operative to offset personal tax.

(c) Reserves, if paid to members in the future, would be taxed at full personal rates.

Co-operative Reserves are Collectively Owned

When one recognizes that co-operatives are best understood as a collective undertaking similar to a special form of limited partnership it will be recognized that the ownership of the assets of a co-operative is really a collective ownership. Likewise, the reserves are created and jointly owned by all in the co-operative.

In fact there are some "agency" co-operatives which now actually divide among their members the annual allocation set aside as a reserve for collective co-operative activity. These amounts are taken by their members into their personal income and dealt with as such. The proposal stated herein merely provides for co-operatives to pay directly this individual tax.

The collective ownership of co-operative reserves is demonstrated by the fact that a member who receives back his member investment receives only his actual investment with no increase or gain. Co-operative law and practice both provide that a member receiving his investment does not share in or receive a ratable portion of a co-operative's unallocated reserves.

No Integration of Taxes Paid by the Co-operative

If the co-operative is to be treated as a "conduit" to pass the savings to the member, the

tax paid on undistributed income accumulated in a co-operative in the future would probably not be substantial because most of the income would be allocated to the members and taxed in their hands. The relatively small amounts paid in tax by the co-operative would be divided among a large number of members for integration with personal tax. The cost of the necessary reporting and accounting might well exceed the amount of the tax. For simplicity it is therefore suggested that the collective tax on retained earnings be the average provincial personal rate and that there be no integration.

Reserves if Paid to Members to be Taxed at Full Personal Rates

While, discretionary reserves in the future for co-operatives, (apart from the annual statutory reserves required) will probably be small, there will undoubtedly have to be set up from time to time by some co-operatives substantial reserves to cover major contingencies, with consequent tax being paid thereon. In addition, there are at present large sums of tax-paid on allocated earnings and surplus accounts and various types of reserves in Canadian co-operatives.

If such reserves are at any time paid out to members they could be treated as income of the recipient and taxed at full personal rates. While double taxation would thus be applied to such distributions, it appears to be the only practical solution since the alternative would involve impractical accounting procedures and reporting expenses.

PART VIII

CONSUMER PATRONAGE REFUNDS

While throughout this submission reference has been to taxability in the hands of the recipient of co-operative distributions it is, of course, common agreement that this is only a substantially correct statement and not an absolutely correct one. At the present time patronage refunds on purchases of consumer goods or on consumer services are not taken into income by the recipient, nor does the White Paper proposal suggest any change in this regard. For clarification, it should be pointed out that consumer type refunds generally result from the purchase of consumer goods.

It is generally accepted that the total amount of patronage refunds in respect of consumer goods and services is relatively minor. It forms a very small part of the known patronage refunds. From the Department of Agriculture

statistics for co-operative operations in Canada for the year 1967, already referred to, it can be estimated that about only 10% of total co-operative operations in 1967 related to consumer goods and services. It is also reasonably estimated that of all patronage refunds about 95% are taken directly into income.

Paragraph 3.3 of the White Paper indicates that the Government rejects the concept of taxing every increase in economic power no matter what its source.

It is suggested that patronage refunds resulting from consumer goods and services should be an instance of an "increase in economic power" which is not taxed. The present principle for the non-taxability of consumer patronage refunds is that such a refund is really a return of an overcharge in respect of the provision of consumer goods or services, the cost of which is not deductible as a business expense.

It is suggested that this principle still applies in the integrated tax system being proposed. The principle as to the nature of the refund has not changed and in addition there are numerous social aspects involved in the taxation of a refund in respect to an item entering into the cost of living. Also, the minor nature of such refunds when applied to members generally puts them into a category of other minor items not included in income..

It is, however, recognized that a possible element of abuse could exist in this matter. The possibilities of such abuse are substantially reduced if the proposal in Part IX for the establishment of a co-operatively-held designation is accepted and proper regulations are prepared as to the co-operatives which could qualify for this designation.

It would appear fair to provide that the rate of patronage refund on consumer goods should bear a direct relationship with the actual surplus realized from the sale of such goods to an ultimate customer for personal consumption.

PART IX

CONCLUSION AND SUMMARY

1. Co-operatives wish to re-emphasize their acceptance of the White Paper proposal that surplus earnings of corporations should be taxed once and at the rate of the recipient, upon such earnings being distributed.

2. Co-operatives approve of the stated intention of the White Paper that in the taxation of the benefits of corporate activity that in order to achieve equity, cognizance must be had of the differing relationships between corporations and their shareholders (members).

3. Co-operatives acknowledge with approval, the White

Paper proposal permitting co-operatives to pass their entire surplus earnings to their members.

4. Co-operatives object strenuously to the White Paper direction, directing the method by which they must distribute their surplus earnings to their members if they are to pass all their surplus earnings to their members for the following reasons:

(a) The proposal providing for such direction fails to take into consideration or allow to operate, the basic nature and method of operation of a co-operative, which is to distribute its surplus earnings to its members in proportion to the business they have done with the co-operative rather than in relation to capital investment.

(b) Co-operative philosophy, regulations and provincial laws make it impossible for most if not all co-operatives to distribute their surplus earnings in the manner proposed.

(c) The proposal fails to recognize or perhaps understand the difference in capital structure between a co-operative and a corporation.

5. Co-operatives propose

(a) That there be deducted from the surplus earnings of the co-operative in calculating taxable income, all distributions made whether by way of a return on member investment or as a patronage refund.

(b) Such distributions made to member patrons shall be dealt with by the recipient in calculating his income.

(c) All undistributed surplus earnings to be taxed in the hands of the co-operative at a collective rate of tax, namely the average provincial tax rate applicable to individuals in the province where the business of the co-operative is carried on.

The principles on which the Co-operative Proposal is Formulated Are

(a) Simplicity

(b) Can be accomplished in conformity with co-operative methods of operation.

(c) The principle of the White Paper is to tax distributions of corporate surplus once.

(d) Income not distributed to be taxed at the collective provincial personal rates since the reserves are collectively owned by the members of the co-operative and there is to be no passing on of creditable tax by the co-operative. Also if the reserves are ever to be paid out they are to be taxed again at full personal rates.

6. Consumer patronage refunds should continue to be non-taxable in the hands of the recipient since such refunds are but a return of a portion of the cost of the purchase of personal goods, the cost of which was not deductible in calculating his income.

After a detailed analysis of the White Paper proposals affecting co-operative methods of doing business and upon an analysis of other proposed methods for the taxation of corporate activity and the distribution of the income derived from such activity it would appear necessary to require a further classification for corporate tax treatment, namely "co-operatively-held". This would then result in corporate treatment in any one of the following categories.

1. Those electing partnership treatment.
2. Co-operatively-held.
3. Closely-held.
4. Widely-held.

As a final comment it should be stated that this submission has been made on the presumption that the White Paper proposals will be substantially implemented in future tax legislation. Should substantial revisions be made to the White Paper proposals with respect to the taxation of corporations, nevertheless, the suggested co-operative approach should be accepted and put into legislation for co-operatives. It provides for a system of taxation which has taken into consideration the method of operations of co-operatives and the element of economic gain realized by the recipient of co-operative distribution.

PART X

COMMENTS ON OTHER WHITE PAPER PROPOSALS

A. ELIMINATION OF THREE YEAR TAX EXEMPTION

While co-operatives are prepared to accept the removal of the three year tax exemption provisions in view of the total tax reform package, it should be pointed out that this provision has served the economy of Canada well in the past. This provision was inserted into the taxation statute in recognition of the difference between co-operative and corporate equity structures. In recent years this section has assisted primarily Indian and Metis groups who form co-operatives to serve their local needs. It is hoped that some alternative, apart from taxation, might be available and be devised to assist these members when they attempt to commence a collective type of activity to serve their needs. It is hoped that such assistance might be devised without creating some form of income to these co-operatives such as the present Area Development Grants.

B. MEETING COSTS

Co-operatives, by their very nature, require a great deal of personal involvement in the democratic operations

of the co-operative. If substantial amendments are made to the existing rules covering convention or meeting costs such provisions must not prohibit the legitimate expenses of co-operative operations. Because it is necessary to bring together the members of the co-operative to give policy guidance for the operations of the co-operative these expenses can be more properly considered an essential business expense of the co-operative rather than a "convention expense."

Experience in co-operatives has shown that meeting costs are modest and it would not be anticipated that this would change. It must be recognized that in a co-operative any increase in cost will result in a direct reduction in the amount of patronage refund receivable by a member and consequently there is a desire to control costs.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

THE CO-OPERATIVE UNION OF CANADA
By its President

W. Breen Melvin

British Columbia Co-operative Wholesale Society
Federated Co-operatives Limited
Maritime Co-operative Services
United Co-operatives of Ontario

LE CONSEIL CANADIEN DE LA COOPERATION
Par son President:

Martin J. Legere

Conseil de la Cooperation due Manitoba
Conseil de la Cooperation de L'Alberta
Conseil de la Cooperation de la Saskatchewan
Conseil de la Cooperation de l'Ontario

Co-operative Vegetable Oils Ltd.
Manitoba Pool Elevators
Saskatchewan Wheat Pool
Alberta Wheat Pool
Co-operative Trust Company of Canada
United Farmers of Alberta Co-operative Limited
Canadian Co-operative Wool Growers Ltd.
Fraser Valley Milk Producers Assn.
Interprovincial Honey Sales
Manitoba Dairy & Poultry Co-op
Canadian Co-operative Implements Ltd.
Interprovincial Co-operatives Limited
Prince Rupert Fishermen's Co-operative Association
United Maritime Fishermen Limited
British Canadian Co-operative Society
Co-operative Hail Insurance Co. Ltd.
Co-operative Insurance Services
Co-operators Insurance Association
British Columbia Co-op Union
Alberta Co-operative Women's Guild
(SASK) Co-operative Development Association
Co-operative Union of Manitoba
Ontario Co-operative Development
New Brunswick Co-op Union
Nova Scotia Co-operative Union
Co-operative Union of P.E.I.
Newfoundland Co-op Services
Saskatchewan Co-operative Women's Guild
Pontiac County Co-operative Medical Services
Co-operative Health Services of Ontario
Saskatchewan Co-operative Credit Society Limited
Canadian Co-operative Credit Society Limited
Ontario Co-operative Credit Society Limited

L'Union Cooperatif Acadianne
Conseil de la Cooperation du Quebec
La Federation des Magasins Co-op
Pecheurs Unis de Quebec
La Federation Co-op-Habitat du Quebec
La Federation de Quebec des U.R. Des C.P.D.
La Federation des Cies D'Ass. Mut. Contre le Fuc
La Federation de Montreal des Caisses Desjardins
La Federation des Ch. Coop. de L'Ouest Quebecois
La Federation des Caisses D'Economie du Quebec
La Federation des Cooperatives Etudiantes du Que.
La Societe des Artisans
L'Assurance-Vie Desjardins
La Mutuelle SSQ
Assurances U.C.C. Compagnie Mutuelle
La Sauvegarde, Compagnie D'Assurance sur la Vie
La Societe D'Assurance des Caisses Populaires
Les Producteurs de Sucre D'Erable du Quebec
L'Institute Cooperatif Desjardins
Societe de Fiducie du Quebec
La Securite, Compagnie D'Ass. Gen. du Canada
L'Association Cooperative Feminine du Quebec
Conseil de la Cooperation du Quebec

SCHEDULE "A"

The International Co-operative Alliance, a world-wide association of co-operatives, has recently reaffirmed the basic co-operative principles. The four principles of concern are:

1. Membership of a co-operative society should be voluntary and available without artificial restriction or any social, political or religious discrimination, to all persons who can make use of its services and are willing to accept the responsibilities of membership.

2. Co-operative societies are democratic organizations. Their affairs should be administered by persons elected or appointed in a manner agreed by the members and accountable to them. Members of primary societies should enjoy equal rights of voting (one member, one vote) and participation in decisions affecting their societies. In other than primary societies the administration should be conducted on a democratic basis in a suitable form.

3. Share capital should only receive a strictly limited rate of interest, if any.

4. Surplus or savings, if any, arising out of the operations of a society belong to the members of that society and should be distributed in such manner as would avoid one member gaining at the expense of others. This may be done by decision of the members as follows:

   (a) by provision for development of the business of the co-operative:

   (b) by provision of common services; or

   (c) by distribution among the members in proportion to their transactions with the society.

SCHEDULE "B"

	Year 1	Year 2	Year 3	Year 4	Year 5
Capital Employed beginning of year	$1,000,000	$991,000	$981,000	$972,000	$962,000
Income equal to deemed return of 8½% of capital employed	$ 85,000	$ 84,000	$ 83,000	$ 82,000	$ 81,000
Income Tax @ 50%	$ 42,000	$ 42,000	$ 41,000	$ 41,000	$ 40,000
Balance allocated to shares	$ 43,000	$ 42,000	$ 42,000	$ 41,000	$ 41,000
Capital employed after allocation	$1,043,000	$1,033,000	$1,023,000	$1,013,000	$1,003,000
Deduct Share redemptions @ 5%	$ 52,000	$ 52,000	$ 51,000	$ 51,000	$ 50,000
Capital employed end of year	$ 991,00	$981,000	$972,000	$962,000	$953,000

NOTE:

Above calculations presume no cash payment either on member capital or as a patronage refund. If cash payments made reduction in capital would be accelerated.

APPENDIX "G"

NAME: THE CO-OPERATIVE UNION OF CANADA

AND

LE CONSEIL CANADIEN DE LA COOPERATION

SUBJECT: Co-operatives

Analysis of Appendix "F" by Senior Advisor

The Brief is presented jointly by The Co-operative Union of Canada and Le Conseil Canadien de la Cooperation and reflects the views of national, regional and provincial co-operatives operating throughout Canada.

The Brief makes submissions upon the following:

(1) The proposal to withdraw the exemption for the first three years of operations.

(2) The proposal to revise the formula for determining the allowable deduction for patronage dividends paid.

(3) The proposal to increase the rate of interest to be paid to members and taxed in their hands.

The Brief can be divided into the following divisions:

(1) Present taxation provisions of co-operative operations. (Pages 4 to 7 of Brief).

(2) Nature of a co-operative. (Pages 7 to 11 of Brief).

(3) Analysis of White Paper proposals. (Pages 12 to 28 of Brief).

(4) Objections to a capital employed and deemed rate of return concept. (Pages 28 to 32 of Brief).

(5) Co-operatives and creditable tax-integration. (Pages 33 and 34 of Brief).

(6) Co-operatives and corporate tax treatment. (Pages 34 to 40 of Brief).

(7) Co-operative proposals. (Pages 40 to 46 of Brief).

(8) Consumer patronage refunds. (Pages 46 to 48 of Brief).

(9) Conclusion and summary. (Pages 48 to 51 of Brief).

(10) Elimination of three year exemption period. (Pages 52 and 53 of Brief).

The attention of the Committee is drawn to the following remarks:

(1) "In view of this, it is amazing and in fact alarming that the proposal relating to co-operatives attempts to direct how co-operatives, a substantial segment of the Canadian economy, are to distribute their annual surplus earnings." (Page 12 of the Brief).

(2) "While criticism is expressed as to the proposal affecting the distribution of co-operative surplus, co-operatives do support the concept of taxation of sources of income in the hands of the individual and at his rates. This is the principle the co-operatives wish to have applied to themselves and their members as well." (Page 15 of the Brief)

(3) "Because of the uncertainty created by the White Paper proposal, if a capital employed formula is implemented then co-operatives must be given the election to include or exclude from any such formula some or all of the investments issued by it bearing a fixed rate of return." (Pages 21 and 22 of the Brief).

(4) "Co-operative members have, however, agreed that the members creating the surplus earnings of the co-operative by their business with the co-operative should be entitled to these surplus earnings. They object to a taxation device refusing them the right to make this decision." (Pages 29 and 30 of the Brief).

(5) "It is felt that the discussion to this point has demonstrated that the White Paper proposal for the taxation of co-operatives will not work and should not be implemented by legislation." (Pages 34 and 35 of the Brief).

(6) "To treat a co-operative as a corporation for tax purposes ignores the nature and ownership of co-operatives distribution and the claim which the patron owners have to the surplus earnings." (Page 38 of the Brief).

The Brief makes the following submissions:

(1) "Co-operatives object strenuously to the White Paper direction, directing the method by which they must distribute their surplus earnings to their members if they are to pass all their surplus earnings to their members for the following reasons:

(a) The proposal providing for such direction fails to take into consideration or allow to operate, the basic nature and method of operation of a co-operative, which is to distribute its surplus earnings to its members in proportion to the business they have done with the co-operative rather than in relation to capital investment.

(b) Co-operative philosophy, regulations and provincial laws make it impossible for most if not all co-operatives to distribute their surplus earnings in the manner proposed.

(c) The proposal fails to recognize or perhaps understand the difference in capital structure between a co-operative and a corporation." (Page 49 of the Brief)

(2) "(a) That there be deducted from the surplus earnings of the co-operative in calculating taxable income, all distributions made whether by way of a return on member investment or as a patronage refund.

(b) Such distributions made to member patrons shall be dealt with by the recipient in calculating his income.

(c) All undistributed surplus earnings to be taxed in the hands of the co-operative at a collective rate of tax, namely the average provincial tax rate applicable to individuals in the province where the business of the co-operative is carried on." (Pages 49 and 50 of the Brief).

(3) "Consumer patronage refunds should continue to be non-taxable in the hands of the recipient since such refunds are but a return of a portion of the cost of the purchase of personal goods, the cost of which was not deductible in calculating his income." (Page 50 of the Brief).

There is attached the usual summary of existing tax laws, White Paper proposals and the principal points of the Brief.

Name: The CO-OPERATIVE UNION OF CANADA

Principal Subject: Co-operatives - patronage dividends

Present Tax Law

Section 75 of the Income Tax Act.

Section 75 provides that all co-operatives and any other corporations may deduct any amount paid or credited to their members on a patronage basis. Subject to a number of conditions and limits:

(a) Prior to the commencement of the fiscal period there must have been held forth the prospect of the patronage allocation:

(b) The patronage allocation must be computed and paid in relation to the business done:

(c) All recipients of patronage allocations are to receive the same rate, provided that if payment is not made to non-members of the co-operative, the co-operative can only pass to members the surplus earnings derived from member business.

(d) Payment of the patronage refund must be made within the taxation year or twelve months thereafter.

White Paper Proposals

4.68 Two rules in the act have a special significance for co-operatives. One provides that a co-operative shall be exempt from income tax for the first three years of its existence. It is proposed that this exemption be withdrawn. If the rules that govern the tax position of co-operatives in the fourth and subsequent years are fair, they should apply to the first three years as well.

4.69 The second rule provides that patronage dividends are deductible in computing the taxable income of the co-operative, subject to a limit. Patronage dividends are deductible before interest paid (other than interest to a bank or credit union) and cannot reduce profits at that point in the computation below 3 per cent of capital employed. This might be thought to ensure that members are taxed on some return on their investment in the co-operative. However, the 3 per cent is far too low in current circumstances. Further, because such other debts as mortgages are taken into account in determining the capital employed, the effective interest taxed to members can be even lower than 3 per cent. (A $200,000 mortgage at an interest rate of 7¼ per cent would result in no taxable return on members' investment of $300,000.)

Principal Points of Brief

Page 34 of the Brief

The Brief points out that, if a cooperative, as a corporate entity, has paid tax and has built up creditable tax, it must be able to elect the procedure for passing on this creditable tax which will be either:

in relation to member investment: or
in relation to patronage refunds

Creditable tax passed along with patronage refunds will have to be a calculated percentage applicable to such refunds to provide for the total passing on of this creditable tax. The percentage rate used will vary from co-operative to co-operative depending on the amount of creditable tax and depending on the amount of patronage refunds paid.

Page 40 of the Brief

The Brief proposes that co-operatives be permitted to deduct all distributions made whether by way of a return on member investment or as a patronage refund, in arriving at taxable income, with all surplus earnings not distributed being taxed to the co-operative at a collective rate of tax.

Name: **THE CO-OPERATIVE UNION OF CANADA**

Principal Subject: **Co-operatives - patronage dividends**

Present Tax Law	White Paper Proposals	Principal Points of Brief
The limits imposed below which a co-operative may not reduce its surplus earnings through the making of patronage refunds are as follows: (a) The surplus earnings may not be reduced below a figure equal to 3% of capital employed less the interest paid on loans other than loans to banks, Credit Unions and Caisses Populaires. (b) The income earned on non-member business that is not distributed to non-members may not be deducted from taxable income. (c) The amount of unallocated reserves. Thus a co-operative presently may not reduce its income by way of paying patronage refunds below the greater of 3% of capital employed, income from non-member business or the amount of reserves.	4.70 The government proposes that the interest rate be set in accordance with a formula comparable to the formula used to determine the rate on farm improvement loans—that is, the rate would vary from year to year depending upon the interest rates paid on government bonds. It is also proposed that only interest paid to members on their loans and capital be taken into account after the deduction of patronage dividends. 4.71 As a result, co-operatives could continue to eliminate taxable income by a combination of patronage dividends and interest to members. However, members would be taxable on a full commercial rate of interest on the investment which they have in the co-operative (provided of course the co-operative earns that much before patronage dividends).	

Name: THE CO-OPERATIVE UNION OF CANADA

Principal Subject: Co-operatives - Taxation of distribution

Present Tax Law	White Paper Proposals	Principal Points of Brief
Sections 6 and 11-1-n of the Income Tax Act. Except for allocations of patronage refunds in respect of consumer goods and services, dividends received by a customer of a co-operative must be included in computing his income. Amounts received by members of a co-operative on his investment in the co-operative are included in his income. If the payment is in the form of dividends on shares the usual 20% dividend tax credit will be available to the recipient.	4.70 The government proposes that the interest rate be set in accordance with a formula comparable to the formula used to determine the rate on farm improvement loans—that is, the rate would vary from year to year depending upon the interest rates paid on government bonds. It is also proposed that only interest paid to members on their loans and capital be taken into account after the deduction of patronage dividends.	Page 43 of the Brief The Brief suggests that surplus earnings retained by the co-operative and set up as a reserve should be taxed at the average personal rate payable by its members. While this statement of this principal is in the ideal form it is recognized that a practical administrative statement would have to be that the undistributed surplus earnings of the co-operative should be taxed at the average provincial personal rate in the province in which the co-operative carries on business.

Name: THE CO-OPERATIVE UNION OF CANADA

Principal Subject: Co-operatives -Exemption

Present Tax Law	White Paper Proposals	Principal Points of Brief
Sections 73 and 62-1-k of the Income Tax Act Section 73 of the Income Tax Act provides that no tax is payable by a co-operative upon any taxable income for each of its first three years of operation, if it meets certain restrictions of operation, which would basically require it to be an operation of local nature only. Section 62 (1) (k) provides that no tax is payable upon any taxable income of Credit Unions and Caisses Populaires which operate in one province and derive their surplus earnings primarily from dealing with their members.	4.68 Two rules in the act have a special significance for co-operatives. One provides that a co-operative shall be exempt from income tax for the first three years of its existence. It is proposed that this exemption be withdrawn. If the rules that govern the tax position of co-operatives in the fourth and subsequent years are fair, they should apply to the first three years as well.	Page 52 of the Brief The Brief states: "While co-operatives are prepared to accept the removal of the three year tax exemption provisions in view of the total tax reform package, it should be pointed out that this provision has served the economy of Canada well in the past. This provision was inserted into the taxation statute in recognition of the difference between co-operative and corporate equity structures. In recent years this section has assisted primarily Indian and Metis groups who form co-operatives to serve their local needs. It is hoped that some alternative, apart from taxation, might be available and be devised to assist these members when they attempt to commence a collective type of activity to serve their needs. It is hoped that such assistance might be devised without creating some form of income to these co-operatives such as the present Area Development Grants."

APPENDIX "H"

BRIEF CONCERNING

PROPOSALS FOR TAX REFORM

Submitted to

THE HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE,

TRADE and ECONOMIC AFFAIRS

and to

THE SENATE COMMITTEE ON BANKING, TRADE and COMMERCE

by the

NATIONAL ASSOCIATION OF CANADIAN CREDIT UNIONS

(NACCU)

TORONTO, ONTARIO APRIL 1970

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TORONTO, ONTARIO APRIL 1970

CONTENTS and SUMMARY

I. INTRODUCTION

- presentation by the National Association of Canadian Credit Unions on behalf of member organizations and the Canadian Co-operative Credit Society.

II. PURPOSE AND SCOPE OF SUBMISSION

Comment constructively on White Paper Proposals, namely Sections 4.68 to 4.73 and Section 5.9 - Credit unions are unique collective organizations - reserves should be related to nature of operations and risks, not similar to those for banking institutions.

III. NATURE OF CREDIT UNIONS AND THEIR FINANCIAL STRUCTURE

An understanding of the true nature - majority still small units - operate on non-profit basis - all under provincial legislation, control and supervision. Share capital akin to bank savings accounts - not transferable - not subject to capital gains - voting not related to number or value of shares.

IV. CREDIT UNIONS AND OTHER COOPERATIVES

Deal only with members - restricted to 6% dividend

on shares - restricted to 12% interest rate except in B.C. - restrictions on allocations of reserves in event of liquidation - returns taxable in hands of members - cooperative returns usually based on participation rather than investment - patronage refunds less important in credit unions - credit unions pay full commercial rates of interest.

V. CAPITAL EMPLOYED AND ITS EFFECTS

Defined as share capital reserves and surplus - shares described as more akin to savings deposits - effects of "pricing out" formula - not in public interest and would defeat tax proposals - interest and dividends must be treated as operating expenses. Need to change legislation to permit continued elimination of taxable income - share capital not locked in and capital employed minimal - credit unions pay commercial rates and arbitrary formula is impractical - patronage refunds should be deductible.

VI. CREDIT UNIONS AND BANKING INSTITUTIONS

Cannot be realistically compared to chartered banks - operate locally only - unable to diversify risks.

VII. RESERVES AND THEIR TREATMENT

Nature of credit union reserves - guarantee funds - stabilization funds - provincial statutory requirements - no discretion as to allocation of reserves - inability to spread risks - preponderance of smaller loans, mostly in instalment category - risk factor greater, requiring higher reserves - stabilization funds as additional safeguards - credit unions reluctant to write off bad loans - reserve ceiling for banks may be adequate, but not for credit unions - credit unions would be subject to taxation on statutory reserves - would encourage a change in operations - provincial reserve requirements should be considered.

VIII. RETROSPECTIVE TAXATION

Reserves accumulated during tax free periods - credit unions would be penalized as at transition date - reserves should not be taken into account for tax purposes.

IX. COOPERATIVE CREDIT SOCIETIES

- No specific proposals in White Paper

- Centrals also under Co-operative Credit Associations Act (federal) - certified by Treasury Board - subject to federal reserve

requirements and rigid liquidity requirements share structure similar to credit unions - arbitrary reserve limitations impractical.

X. ENTERTAINMENT AND RELATED EXPENSES

Credit unions unique voluntary organizations - incentives to participate should not be discouraged.

XI. SUMMARY AND CONCLUSION

Dividends on capital and loan interest refunds should be deductible - bad debt and market liquidity reserves should be those required by provincial statutes - accumulated reserves should not be considered as opening reserves - assessments and losses re stabilization funds should be deductible - participation in meetings should not be discouraged - credit unions as unique personal organizations, distinguishable from banking institutions and other cooperatives - growth not proper criteria for taxation - need for higher reserves - capital gain remote - returns to members fully taxable in their hands - exemption should continue - single taxation concept fair and should be supported.

BRIEF CONCERNING

PROPOSALS FOR TAX REFORM

Submitted to

THE HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE,

TRADE and ECONOMIC AFFAIRS

and to

THE SENATE COMMITTEE ON BANKING, TRADE and COMMERCE

by the

NATIONAL ASSOCIATION OF CANADIAN CREDIT UNIONS

(NACCU)

I. INTRODUCTION

1.1 The National Association of Canadian Credit Unions (NACCU) respectfully submits its brief on the subject of taxation reform on behalf of its member organizations.

1.2 NACCU was incorporated in 1958 to provide federal representation for credit union member organizations and to coordinate the activities of the Canadian credit union movement.

1.3 Our brief represents the views of 2797 credit unions with 2.5 million members and assets totalling $1.9 billion.

1.4 We have also been authorized to represent the views of the Canadian Co-operative Credit Society in those sections of the brief which apply to provincial credit union centrals and co-operative credit societies.

II. PURPOSE AND SCOPE OF SUBMISSION

2.1 Since one Canadian in four is now a member of a credit union or caisse populaire, the proposals as contained in the White Paper could have a profound effect on the credit union members both as citizens and consumers, and also on the 4,520 credit unions and caisses populaires which service them.

2.2 The purpose of this brief is to comment constructively on some of the proposals contained in the "Proposals for Tax Reform" tabled in the House of Commons, in November, 1969, by the Honourable Mr. E. Benson.

2.3 Although the White Paper proposals will directly or indirectly affect all citizens of Canada, we propose to deal mainly with the sectionsof the White Paper concerning credit unions, namely Sections 4.68 to

4.73 inclusive, and Section 5.9 dealing with entertainment and related expenses.

2.4 Specifically, the White Paper states that

(a) "originally caisses populaires and credit unions were small organizations serving limited groups of people basically on a non-profit basis. However with the increased scope of their activities and operations, some of them are in real competition with other financial institutions."

2.5 This would appear to be the basis upon which the government proposes to remove the tax exempt status of credit unions, as determined by section 62(1)(k) of the Income Tax Act.

2.6 (b) "The government proposes to treat caisses populaires and credit unions as other co-operatives are treated."

2.7 We shall endeavour to point out, that credit unions are a unique type of collective organization, similar in some respects to other cooperatives and financial institutions, but with certain essential characteristics which set them apart operationally.

2.8 (c) "They would of course be granted deductions for doubtful debt reserves and market

liquidity reserves comparable to those allowed to banking institutions."

2.9 As we shall examine later, suitable reserves should be allowed as deductions for credit unions having regard to the nature of their operations and risks.

2.10 We shall attempt to clarify our position within the context of the White Paper proposals, and point out the inequity and impracticability of the proposals, with particular emphasis on the following:

- Nature of credit unions and their financial structure
- Credit unions and other cooperatives
- Capital employed and its effects
- Credit unions and banking institutions
- Reserves and their treatment
- Retrospective taxation
- Cooperative credit societies
- Entertainment and related expenses

III. NATURE OF CREDIT UNIONS AND THEIR FINANCIAL STRUCTURE

3.1 In order to logically analyse the proposals of the White Paper, it is first of all necessary to understand the true nature of credit unions, and their financial structure. This is particularly important when Section 4.73 proposes that the government treat

credit unions like other cooperatives on the one hand, and permit deductible reserves comparable to those allowed banking institutions on the other.

3.2 Section 4.72 states "originally caisses populaires and credit unions were small organizations serving limited groups of people basically on a non-profit basis." While it is true that some credit unions have grown substantially in size of membership and assets, the vast majority of credit unions are still relatively small and continue to serve their membership on a restricted bond of association basis, through the efforts of volunteer directors and officers. As the International Credit Union Yearbook (1969) points out at page 15, 68.47% of all Canadian credit unions and caisses populaires (approximately 3100) each have total assets of less than $500,000.

3.3 Despite the increased scope of activities that some larger credit unions enjoy, their non-profit nature still remains, and as such, no appreciable economic gain accrues to the credit union, as distinct from the economic gain accruing to the individual members.

3.4 All credit unions operate under the provisions of provincial legislation regardless of size. Regulation, control and supervision are administered by provincial authorities.

3.5 Very few, if any, credit unions are in real competition with other financial institutions, except as to the attraction of savings for the benefit of the member.

3.6 The share capital in a credit union does not consist of shares in the normal corporate sense but is more akin to the savings accounts in a chartered bank, which are withdrawable on demand. Although these shares are usually designated by $5 units, they are recorded in passbooks or statements, and no share certificates as such are issued. Such shares are redeemable on demand and in fact turn over continually. They are not transferable, and are not subject to any capital gains.

3.7 Voting rights of members are not related to the number or value of shares held, but rather are related to the movement-wide principle of "one member - one vote." This principle is indicative of the non-profit nature of credit unions.

IV. CREDIT UNIONS AND OTHER COOPERATIVES

4.1 Although credit unions are similar to other forms of cooperatives in principle and organization as a collective form of enterprise, there are basic differences and characteristics which distinguish them from other cooperatives and as such they should

not be considered in that light for tax purposes.

4.2 Credit unions, as financial intermediaries, are essentially restricted to dealing with their own members. They provide a source of credit when needed by members at reasonable rates of interest, mainly from a common pool of savings, accumulated by the members themselves.

4.3 Because its owners are also its customers, the credit union acts simply as an agent for its members; and any earned income is merely a form of savings returned to them after statutory and other specified reserves are set aside.

4.4 In all but three provinces, credit unions are restricted by statute to a maximum interest or dividend on share capital of 6 per cent per annum.

4.5 Credit unions are restricted by statute to a maximum loan interest rate of 12 per cent per annum (except in British Columbia, where a recent amendment to that Act permits a maximum rate of 15 per cent on loans not falling within the meaning of the Small Loans Act).

4.6 In the event of liquidation, the legislation in at least three provinces prohibits any distribution of unallocated surpluses or reserves to the members.

Such amounts must be allocated to specified community projects, provincial stabilization funds, or other government approved projects. In the other provinces, members have rarely ever made capital gains on liquidation. As such, there is no incentive for members to build up excessive reserves with a view to capital gains or to postpone any tax liability.

4.7 As the Carter Commission recognized, there is a common denominator of membership in a credit union, but some conflict of economic interest between the savers and the borrowers. This conflict virtually assures a reasonable interest charge to borrowers and a reasonable return to the savers.

4.8 Savings deposited by a credit union member at competitive market rates, and any returns accruing, whether as interest or dividend on his shares or deposits, are withdrawable immediately, and income tax is forthwith exigible from the member, whether he withdraws such amounts or not.

4.9 By comparison, share capital investments by a member in a cooperative are usually minimal, and are increased by patronage refunds allocated on the basis of participation in the business of the cooperative, rather than by a return on his

investment. Such investments are normally withdrawable on a "revolving fund" basis, or upon death or retirement.

4.10 Because of competitive pressures from the market place, and statutory maximum loan interest rates, credit unions are generally reducing, or eliminating their interest refund allocations, and distributing a larger share of their earnings by way of a return on shares or deposits.

4.11 Cooperatives on the other hand, still allocate a substantial portion of their surpluses, based on member participation, rather than on member investment in the cooperative.

4.12 Since credit unions already pay full commercial rates of interest, on which their members are taxable, the proposals contained in sections 4.70 and 4.71 of the White Paper, with respect to patronage dividends, are not valid and patronage dividends should be deductible.

V. CAPITAL EMPLOYED AND ITS EFFECTS

5.1 In order to analyse Sections 4.69 and 4.70, it is necessary to define the term "capital employed." Although this term is defined in Section 75 of the Income Tax Act, the unique financial structure of

a credit union makes it difficult, if not impossible to define capital employed, using the definition as contained in that section of the Income Tax Act.

5.2 For discussion purposes we are assuming that "capital employed" is taken to be essentially the share capital contributed by the membership, plus accumulated reserves and surpluses.

5.3 Assuming that this definition is the one used for purposes of the proposals, it is obvious that the true nature of the financial structure of credit unions is completely misunderstood.

5.4 In a credit union, a member increases his investment by direct deposit in either his share account or some form of deposit account. These accounts would normally earn interest or dividends, depending upon the annual earnings of the credit union, after statutory reserves have been set aside.

5.5 It is interesting to note that the Select Committee on Company law (Ontario) in its report of December 1969 at page 22, paragraph 2, distinguished shares as follows: "while from a strictly legal point of view shares in a credit union may be regarded as risk capital in the event of liquidation, they resemble more closely savings deposits."

5.6 It is important to recall the Porter Commission

Report which stated on page 162 "dividends paid on their shares are in all essentials similar to interest paid on deposits. Indeed, the similarity is so close that if taxes were to be applied to this part of income, credit unions could very easily alter the form of payment to their members so that it became in all respects a fixed interest cost, deductible for tax purposes. Nor would this change the position of the members since earnings on credit union shares are now taxable in their hands as interest."

5.7 In effect, this would mean a transfer from share capital to deposit capital, upon which a fixed rate of interest would be payable, thereby reducing net earnings for tax purposes, and decreasing the normal allocations to statutory reserves. We submit that this "pricing out" formula is not a desirable one, would be contrary to the public interest, and would have a serious effect on the sound operations of credit unions.

5.8 Consequently, interest or dividends on shares in a credit union, which are taxable in the hands of the member, must be treated as an operating expense, similar to any fixed interest paid on deposits or borrowed money. Otherwise credit union members would be inclined to withdraw their shares and to reinvest

such amounts in deposits at fixed interest rates, or deposit their funds in other institutions. This practice would not only defeat any proposal to tax credit unions but it would also tend to undermine the continued sound operation of credit unions.

5.9 In connection with Section 4.70, we have been assured by the Minister of Finance through the Honourable H. Gray that "dividends on the capital of credit unions, as in the case of cooperatives, would have to be deductible from income by a legislation change, in order that as indicated in paragraph 4.71 they 'could continue to eliminate taxable income by a combination of patronage dividends and interest to member'."

5.10 Because shares in a credit union are not shares in the normal corporate sense, there is no such thing as "locked-in" share capital. In effect it may be said then, that credit unions have no capital employed, as such, unless unallocated reserves and surpluses can be so classified.

5.11 Section 4.70 suggests that an interest rate be set in accordance with a formula comparable to the formula used to determine the rate for Farm Improvement Loans.

5.12 Because of the true nature of capital employed in credit unions, we cannot agree that such a formula can realistically apply to credit unions. Because credit unions normally pay commercial rates of interest on savings, no theoretical rates as proposed in Section 4.70 should be stipulated and patronage dividends should be deductible.

VI. CREDIT UNIONS AND BANKING INSTITUTIONS

6.1 It is recognized that credit unions accept savings from their members, and make low cost credit available to those same members, within a common bond of association. As such, credit unions are, of course, financial institutions. However, because of the reasons stated above, they are a unique form of financial institution and to compare them with other financial institutions, such as chartered banks, is completely unrealistic.

6.2 Credit unions are autonomous, independent organizations and almost all of them operate in a well defined local area. As a separate corporate entity, they relate separately to their own members, as distinct from the multi-office operations of banking institutions.

6.3 Chartered banks, for many years, have accumulated

reserves and low cost funds, on a nationwide, branch basis, without any limitations such as apply to credit unions. Even the largest credit unions, because of these restrictive limitations, cannot be considered realistically to be competitive with chartered banks.

6.4 The Porter Report pointed out, on page 163, "as small local institutions, they are not able to diversify their risks as well as the large intermediaries."

VII. RESERVES AND THEIR TREATMENT

7.1 Section 4.73 of the White Paper proposes deductions for doubtful debt reserves and market liquidity reserves comparable to those allowed banking institutions.

7.2 A thorough examination of the nature of credit unions, as outlined above, and provincial statutory reserve requirements will clearly demonstrate the unfairness and inequity of such proposals, if the word "comparable" in Section 4.73 is interpreted to mean "the same as."

7.3 We must conclude that the "comparable" reserves referred to, do not mean "the same as." On the contrary, we can only assume that it was intended

as an invitation to credit unions to indicate to the government provisions which would be reasonably comparable having regard to the differing factors which enter into the risks required to be reserved against by banking institutions and those required to be reserved against by credit unions.

7.4 In response to the request from the Minister of Finance that "the government would be interested in receiving their detailed views as to the reserves which they consider necessary ... " we offer the following comments.

7.5 As mentioned previously, credit unions are, without exception, required to set aside guarantee fund reserves (bad debt and investment loss reserves), which are based on the long experience of provincial supervisory authorities.

7.6 An examination of Table 2, page 19 of the CUNA International Yearbook (1969) indicates that Canadian credit unions have set aside total reserves of some \$160 million, or about 6½% of total loans outstanding at the end of 1968.

7.7 Although these totals include general and liquidity reserves, an estimated \$75 million, or 3% of loans outstanding could be considered as statutory reserves.

7.8 A detailed study made by the British Columbia Credit Union Reserve Board showed guarantee reserves on a consolidated basis, including provisions for delinquency (required under Section 34(5) of the Credit Unions Act) were 4.22% of total loans outstanding as at December 31, 1968. After deducting provisions for delinquency, guarantee reserves totalled 2.85% of loans outstanding.

7.9 Similarly the Saskatchewan government report for the year ended December 31, 1968 showed statutory reserves on a consolidated basis, amounting to 3.35% of loans outstanding.

7.10 All provincial statutes require allocations to guarantee reserves, and to stabilization fund reserves in an amount of at least 20 per cent of net earnings, (or 10 per cent of gross earnings), before payment of any return on share capital is made.

7.11 In almost all provinces, credit unions are required to continue such annual allocations to reserves until they reach at least 5% of loans outstanding.

7.12 Provincial authorities are responsible for the day to day supervision of credit unions. They are, therefore, in a better position to determine appropriate reserves, to assure sound operations,

than are federal authorities, responsible for similar supervision of banking institutions.

7.13 Because of such statutory requirements, credit unions have no discretion as to the allocation of such minimum reserves and these amounts should therefore be excluded entirely from income for tax purposes.

7.14 Unlike chartered banks, credit unions are not able to spread their risks to the same degree. Credit unions also have a preponderance of small loans issued to people of a more limited credit worthiness.

7.15 A recent survey conducted by university economists in British Columbia indicated that 45.6% of credit union members in that province earn between $4,800 and $8,400 per annum. In addition, 24.7% of the membership earns less than $4,800 per year.

7.16 The majority of loans from credit unions are in the personal instalment category. Personal loans, for example, accounted for some 70% of total loans outstanding in Canadian credit unions at the end of 1968. On the other hand, only about 27% of total loans outstanding with chartered banks were in the same category. [i.]

i. Canadian Statistical Review (D.B.S.) March 1970, Page 81, Table 4 - Page 95, Table 2.

7.17 Loans made to persons in the lower-middle income position tend to be small personal loans carrying a much greater risk factor which must be reserved against if the soundness of credit unions is to be maintained.

7.18 Credit unions do not have the diversification of risk which banking institutions have regarding other types of loans which are larger in amount, better secured and easier to collect. The diversification of credit union loans is also greatly restricted by the fact that credit unions are local in their operations, dealing only with members.

7.19 Further, as pointed out in the Porter Report, because credit unions have long provided credit life insurance on their loans, they tend not to write off such loans as rapidly as other financial institutions.

7.20 The establishment and development of stabilization funds (somewhat similar to the protection offered by the Canada Deposit Insurance Corporation) in the various provinces, adds strength and safety to the deposits of the members, and indicates that guarantee fund appropriations, as such, are not excessive. Compulsory participation in like provincial reserve or stabilization funds was recommended in the Porter Report.

7.21 It should be pointed out too, that credit union reserves have been created, not to avoid income tax (since they are not generally taxable) but to protect the members and the public interest.

7.22 Credit unions, because of the relatively small size of the majority of them, have not customarily written off bad debts, without exhausting every means of collecting them. The underlying purpose of a credit union is to help its members and, therefore, it tends to be more lenient as to terms of loans and collections.

7.23 We are of the opinion that chartered banks, on the other hand, being much more sophisticated in the use of tax free reserves, find the reserve limitations of 1½ per cent on specified assets, adequate in most cases.

7.24 If such a percentage of 1½ per cent is deemed reasonable for banks in respect of a substantial part of their loan portfolio, then certainly a much higher rate would be required for credit unions because of the essential differences in their operations, the nature of their loan portfolios, the spread of risk, and the nature of the securities commonly used.

7.25 In many instances, the statutory reserves have

proved to be barely adequate. Even though guarantee fund reserve allocations, will in almost all cases exceed the 1½ per cent ceiling applicable to banks, such a limitation, if applied to credit unions, would put credit unions into the indefensible position of having to pay substantial taxes on earnings, which by provincial statute, must be transferred to statutory reserves.

7.26 The effect of this provision would be to encourage credit unions to change their methods of operation, as indicated in paragraph 5.7, in order to distribute larger amounts and reduce their normal allocations to reserves.

7.27 Therefore, we believe that the statutory reserves for credit unions as specified by the various provincial acts are fair and valid, and that provincial reserve requirements should be taken into consideration by the federal government in any taxation proposals.

VIII. RETROSPECTIVE TAXATION

8.1 During past years, credit unions have accumulated certain reserves, as previously mentioned, in conformity with sound business practices, the philosophy of the movement, and statutory requirements deemed necessary by provincial supervisory

authorities. These reserves have been accumulated during a time when credit unions were not taxable, to give added protection to the savings of millions of Canadians.

8.2 The White Paper makes no reference to the status of these reserves, at the time taxation would take effect.

8.3 If such reserves and surpluses are taken into account, then the end result would be to tax those credit unions retrospectively on income which was exempt from tax when the reserves and surpluses were set up. Credit unions which operated more prudently and consequently set aside higher reserves, would be unduly penalized.

8.4 It is therefore our contention that statutory reserves accumulated during such periods, should not be considered as opening reserves for tax purposes.

IX. COOPERATIVE CREDIT SOCIETIES

9.1 The White Paper does not specifically suggest any proposals for taxation of credit societies, or as they are frequently referred to, central credit unions. These centrals are organized in every province, either under the same Act as credit unions, or by special Act. Four of these

centrals, namely those in British Columbia, Saskatchewan, Manitoba, and Ontario are also certified by the federal Treasury Board, and as such are deemed to be incorporated under the Co-operative Credit Associations Act. Consequently, they are subject to the limitations of some parts of the federal Act and are subject to supervision by the federal Superintendent of Insurance. In addition, certifications are pending for the Credit Union Federation of Alberta and the Terra Nova Cooperative Credit Society in Newfoundland.

9.2 By virtue of federal statutes, they are required to

(a) transfer into guarantee reserves each year not less than 20% of surplus before paying interest on shares or making other distribution to members,

(b) to value their securities at market,

(c) to value their outstanding loans on an arbitrary basis set out in the Co-operative Credit Associations Act intended to reduce the value of loans to estimated realizable value.

9.3 Member centrals are also required to meet rigid liquidity requirements totalling 20% of deposits, in cash, government securities and deposits with the Canadian Co-operative Credit Society.

9.4 All of these requirements are more stringent than those applicable to banking institutions, having regard to the inability of the centrals to spread their loan risks as widely as banking institutions do.

9.5 Shares in centrals may be redeemed under certain conditions but only on the basis of the amounts paid thereon. There is no market for these shares nor is there any probability of capital gain to shareholders on the redemption of shares.

9.6 As such, any evaluation to determine capital gain, would be meaningless and any provisions pertaining to capital gains should not be applicable to the shares of a central credit union.

9.7 Since the central credit unions are subject to the statutory reserve requirements as outlined in both the provincial and federal legislation under which they operate, it would be unreasonable and inequitable to assume that any arbitrary reserve limitations, should be imposed under provisions of the Income Tax Act, as may be suggested by the proposals for credit unions in the White Paper.

X. ENTERTAINMENT AND RELATED EXPENSES

10.1 Section 5.9 of the White Paper proposes to deny

deductions for .... "the costs of attending or sending employees to conventions." Credit unions, because of their unique membership structure and a high degree of personal participation by volunteer directors and officers in their affairs, would suffer substantially from any such provisions. In addition to such voluntary unpaid participation, members would be reluctant to abuse such current provisions, since high expenses would tend to minimize returns to themselves as depositors and/or borrowers. Therefore, we would not favor any proposal which would discourage active participation by volunteers in the affairs of their own organizations.

XI. SUMMARY AND CONCLUSION

11.1 In summary, we believe that, for tax purposes:

(1) Dividends on capital and loan interest refunds (patronage dividends) should be deductible from income

(2) Allowances for bad debt and market liquidity reserves, should be those amounts required by provincial statutes, or by federal statutes, in the case of centrals

(3) Accumulated reserves should not be considered

as opening reserves

(4) Assessments paid to, or losses incurred on investments in, credit union stabilization or reserve funds should be deductible

(5) Participation in general meetings should not be discouraged by denial of tax deduction of costs of attending such meetings

11.2 Credit unions are a unique agency form of collective enterprise. They have an unusual, personal, owner-customer relationship with their members, with any surplus earnings, apart from necessary provincial statutory reserves, allocated to the members. This feature is certainly distinguishable from the operations of the banking system.

11.3 Because of steadily increasing interest rates generally, patronage dividends in credit unions are becoming much less significant and to this extent may be distinguished from cooperatives.

11.4 Growth in itself has not contributed to any motivational changes, and is not a proper criteria for any proposed tax legislation. Credit unions still operate on a restrictive non-profit basis.

11.5 Because of the true nature and financial structure

of credit unions, their need for higher reserves than other financial institutions, the remote possibility of capital gains, and the fact that returns to the members by way of interest or dividends are fully taxable in their hands, we submit that it would be fair and equitable to continue the present exemption for credit unions under the Income Tax Act.

11.6 While we can agree that periodic reexamination of Canada's taxation statutes is necessary, we cannot agree to the recommendations and conclusions as outlined in Sections 4.72 and 4.73 of the White Paper.

11.7 The concept of single taxation of the individual credit union member at a personal rate of taxation is a fair one and should be supported.

Respectfully submitted by

NATIONAL ASSOCIATION OF CANADIAN CREDIT UNIONS

on behalf of the following organizations:

B.C. Central Credit Union
Credit Union Federation of Alberta Ltd.
Saskatchewan Co-operative Credit Society, Ltd.
Credit Union League of Manitoba 1967 Limited
Co-operative Credit Society of Manitoba Limited
Ontario Credit Union League Ltd.
Quebec Credit Union League
Nova Scotia Credit Union League
Prince Edward Island Credit Union League
Newfoundland Co-operative Services
Co-operative Trust Company of Canada, Ltd.
Canadian Co-operative Credit Society

APPENDIX "I"

NAME: NATIONAL ASSOCIATION OF CREDIT UNIONS

SUBJECT: Credit Unions

Analysis of Appendix "H" by Senior Advisor

This brief is submitted by the National Association of Credit Unions on behalf of the following:

B.C. Central Credit Union
Credit Union Federation of Alberta Ltd.
Saskatchewan Co-operative Credit Society, Ltd.
Credit Union League of Manitoba 1967 Limited.
Co-operative Credit Society of Manitoba Limited.
Ontario Credit Union League Ltd.
Quebec Credit Union League.
Nova Scotia Credit Union League.
Prince Edward Island Credit Union League.
Newfoundland Co-operative Services.
Co-operative Trust Company of Canada, Ltd.
Canadian Co-operative Credit Society.

"The National Association of Credit Unions was incorporated in 1958 to provide federal representation for credit union member organizations and to coordinate the activities of the Canadian credit union movement."

"Our brief represents the views of 2797 credit unions with 2.5 million members and assets totalling $1.9 billion."

"We have also been authorized to represent the views of the Canadian Co-operative Credit Society in those sections of the brief which apply to provincial credit union centrals and co-operative credit societies."

The brief deals mainly with Paragraphs 4.68 to 4.73 of the White Paper.

A summary of the recommendations of the brief are:

"Dividends on capital and loan interest refunds (patronage dividends) should be deductible from income."

"Allowances for bad debt and market liquidity reserves, should be those amounts required by provincial statutes, or by federal statutes, in the case of centrals."

"Accumulated reserves should not be considered as opening reserves."

"Assessments paid to, or losses incurred on investments in, credit union stabilization or reserve funds should be deductible."

"Participation in general meetings should not be discouraged by denial of tax deduction of costs of attending such meetings."

"Credit unions are a unique agency form of collective enterprise. They have an unusual, personal, owner-customer relationship with their members, with any surplus earnings, apart from necessary provincial statutory reserves, allocated to the members. This feature is certainly distinguishable from the operations of the banking system."

"Because of steadily increasing interest rates generally, patronage dividends in credit unions are becoming much less significant and to this extent may be distinguished from cooperatives."

"Growth in itself has not contributed to any motivational changes, and is not a proper criteria for any proposed tax legislation. Credit unions still operate on a restrictive non-profit basis."

"Because of the true nature and financial structure of credit unions, their need for higher reserves than other financial institutions, the remote possibility of capital gains, and the fact that returns to the members by way of interest or dividends are fully taxable in their hands, we submit that it would be fair and equitable to continue the present exemption for credit unions under the Income Tax Act."

"While we can agree that periodic re-examination of Canada's taxation statutes is necessary, we cannot agree to the recommendations and conclusions as outlined in Sections 4.72 and 4.73 of the White Paper."

"The concept of single taxation of the individual credit union member at a personal rate of taxation is a fair one and should be supported."

Name: NATIONAL ASSOCIATION OF CANADIAN CREDIT UNIONS

Principal Subject: Reserves

Present Tax Law	White Paper Proposals	Principal Points of Brief
Section 11-4 of the Income Tax Act This section permits banks to deduct reserves, that in the opinion of the Minister of Finance are not excessive, in determining income.	4.73 The government proposes to treat caisse populaires and credit unions as other co-operatives are treated. They would of course be granted deductions for doubtful debt reserves and market liquidity reserves comparable to those allowed to banking institutions. 5.7 The goodwill of a business has been described as the value that can be placed on the fact that customers are more likely to trade with that firm than with a new firm in the same line. This likelihood arises in part as a result of advertising and in part because customers have been satisfied in their past dealings with the firm. Clearly, goodwill is a thing that must be kept up. If a firm stops advertising or if it stops giving satisfactory service, its goodwill will disappear. Therefore, the goodwill that a firm has now is the result of its past actions, and the goodwill that it has five years from now will be the result in part of its past actions and in part of its actions in the next five years. The government proposes to recognize this fact in the treatment of taxpayers who sell goodwill in the future. The longer the period after the beginning of the new system before the sale takes place, the more of the proceeds of sale that would be taxable and the smaller the part of the proceeds that would be exempt.	Parts V11 and V111, Page 14 of Brief This portion of brief states: 7.27 Therefore, we believe that the statutory reserves for credit unions as specified by the various provincial acts are fair and valid, and that provincial reserve requirements should be taken into consideration by the federal government in any taxation proposals. 8.4 It is therefore our contention that statutory reserves accumulated during such periods, should not be considered as opening reserves for tax purposes.

Name: NATIONAL ASSOCIATION OF CANADIAN CREDIT UNIONS

Principal Subject: Co-operative Credit Societies

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Paragraphs 9-1 to 9-7, Page 21 of Brief 9.1 The White Paper does not specifically suggest any proposals for taxation of credit societies, or as they are frequently referred to, central credit unions. These centrals are organized in every province, either under the same Act as credit unions, or by special Act. Four of these centrals, namely those in British Columbia, Saskatchewan, Manitoba, and Ontario are also certified by the federal Treasury Board, and as such are deemed to be incorporated under the Co-operative Credit Associations Act. Consequently, they are subject to the limitations of some parts of the federal Act and are subject to supervision by the federal Superintendent of Insurance. In addition, certifications are pending for the Credit Union Federation of Alberta and the Terra Nova Cooperative Credit Society in Newfoundland.

Name: NATIONAL ASSOCIATION OF CANADIAN CREDIT UNIONS

Principal Subject: Co-operative Credit Societies

Present Tax Law	White Paper Proposals	Principal Points of Brief
		9.2 By virtue of federal statutes, they are required to (a) transfer into guarantee reserves each year not less than 20% of surplus before paying interest on shares or making other distribution to members, (b) to value their securities at market, (c) to value their outstanding loans on an arbitrary basis set out in the Co-operative Credit Associations Act intended to reduce the value of loans to estimated realizable value. 9.3 Member centrals are also required to meet rigid liquidity requirements totalling 20% of deposits, in cash, government securities and deposits with the Canadian Co-operative Credit Society.

Name: NATIONAL ASSOCIATION OF CANADIAN CREDIT UNIONS

Principal Subject: Co-operative Credit Societies

Present Tax Law	White Paper Proposals	Principal Points of Brief
		9.4 All of these requirements are more stringent than those applicable to banking institutions, having regard to the inability of the centrals to spread their loan risks as widely as banking institutions do. 9.5 Shares in centrals may be redeemed under certain conditions but only on the basis of the amounts paid thereon. There is no market for these shares nor is there any probability of capital gain to shareholders on the redemption of shares. 9.6 As such, any evaluation to determine capital gain, would be meaningless and any provisions pertaining to capital gains should not be applicable to the shares of a central credit union.

Name: NATIONAL ASSOCIATION OF CANADIAN CREDIT UNIONS

Principal Subject: Co-operative Credit Societies

Present Tax Law	White Paper Proposals	Principal Points of Brief
		9.7 Since the central credit unions are subject to the statutory reserve requirements as outlined in both the provincial and federal legislation under which they operate, it would be unreasonable and inequitable to assume that any arbitrary reserve limitations, should be imposed under provisions of the Income Tax Act, as may be suggested by the proposals for credit unions in the White Paper.

Name: NATIONAL ASSOCIATION OF CREDIT UNIONS

Principal Subject: Entertainment Expenses

Present Tax Law	White Paper Proposals	Principal Points of Brief
The Income Tax Act permits the deduction of entertainment expenses. Section 12-2 enables the tax collector to disallow amounts which are unreasonable.	1.35 Various fringe benefits received by employees or by the owners of businesses would be included in income for the first time. For example, an employee or owner of a business with a business-owned car available for his personal use would be required to include a minimum amount in his taxable income unless he pays the business at least that amount for the use of the car. There are other fringe benefits whose value cannot readily be measured in the hands of the recipient; for example, the use of hunting and fishing lodges, yachts and airplanes, the payment of social and recreational club dues, and the entertainment costs that are included in expense accounts. These costs would no longer be deductible to the employer. 5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.	Paragraph 10.1, page 23 of Brief This portion of the brief states: "Therefore, we would not favor any proposal which would discourage active participation by volunteers in the affairs of their own organizations."

APPENDIX "J"

B R I E F

O N

P R O P O S A L S F O R T A X R E F O R M

OF THE

F E D E R A L G O V E R N M E N T

jointly presented by

- LA FÉDÉRATION DE QUÉBEC DES UNIONS RÉGIONALES DES CAISSES POPULAIRES DESJARDINS

- LA FÉDÉRATION DE MONTRÉAL DES CAISSES DESJARDINS

- LA FÉDÉRATION DES CAISSES D'ÉCONOMIE DU QUÉBEC

Lévis, March 31st 1970

B R I E F

O N

P R O P O S A L S FOR T A X R E F O R M

OF THE

F E D E R A L G O V E R N M E N T

jointly presented by

- LA FÉDÉRATION DE QUÉBEC DES UNIONS RÉGIONALES DES CAISSES POPULAIRES DESJARDINS
- LA FÉDÉRATION DE MONTRÉAL DES CAISSES DESJARDINS
- LA FÉDÉRATION DES CAISSES D'ÉCONOMIE DU QUÉBEC

Lévis, March 31st 1970

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INTRODUCTION

This brief was prepared by La Fédération de Québec des Unions régionales des Caisses populaires Desjardins, grouping in Québec 1310 Caisses populaires, owned by 2,375,000 members. As of December 1969, the total assets of these 1310 Caisses populaires amounted to $ 1,854,000,000.

Even though the figures mentioned in this brief refer solely to the Caisses populaires affiliated to the Fédération de Québec des Unions régionales des Caisses populaires Desjardins, two other federations of savings and credit unions express their agreement with the content of this brief and join the Fédération de Québec in presenting it. The federations concerned are : La Fédération de Montréal des Caisses Desjardins grouping 33 Caisses populaires owned by 150,850 members with total assets of $ 161,697,000. as of December the 31st 1969, and La Fédération des Caisses d'Economie du Québec grouping 195 Caisses d'économie owned by 120,720 members with total assets of $ 74,657,000. as of December the 31st 1969. The three federations mentioned above represent 95% of the savings and credit unions operations in Quebec.

The Caisses populaires[1] are savings and credit cooperatives at the service of its user-members. Up to now they were tax exempted on their annual operating surplus paid into the reserve funds. The Caisses populaires though not in accordance with the special treatment offered them in the White Paper in regard to the proposals for tax reform, are nevertheless in accordance with the general proposals for integration provided in this White Paper.

1) In this brief, the name caisse populaire must, as a rule, be taken in the general sense of savings and credit unions; it includes then the caisse d'économie du Québec.

To that effect, they subscribe to the proposals made jointly by the Co-operative Union of Canada and the Conseil Canadien de la Coopération, requesting, in their brief, that the cooperatives may be granted a personal taxation treatment respecting at the same time the basic principles of Minister Benson's White Paper and the basic principles of the cooperative associations.

WHAT ARE THE CAISSES POPULAIRES

The Caisses populaires are savings and credit cooperatives created to provide for their user-members the general financial services they require, particularly in receiving deposits and in granting loans. These financial services are offered on a cooperative basis, that is respecting the principles of co-operation.

A) Characteristics of the Caisses populaires

We do not want to get into semantic arguments, but at the outset of this brief, we believe it is necessary to define at this point, the legal characteristics of the Caisses populaires. These legal characteristics come from the act governing them and are in conformity with the co-operative principles. We would like, at this point, to bring out especially what differentiates a Caisse populaire from an ordinary corporate organization.

1. Whereas in ordinary corporation organization the common share capital is not redeemable, in a Caisse populaire the capital stock is repayable to the members (sec. 25 and 29 of our Act). At the Caisse populaire, the capital stock is an entry in a savings book; a deposit made to-day may be withdrawn to-morrow. This capital stock may increase or decrease; it may be repaid entirely if a member decides not to participate any more to the Caisse populaire. The McDougall Commission, the Porter Commission, and the Carter Commission have all acknowledged that our "dividends paid on shares are in all essentials similar to the interests paid on deposits"[1] due precisely to the characteristics of the capital stock of the Caisses populaires.

1) Report of the Royal Commission on Banking and Finance, Ottawa 1964, p. 162.
See also Report of the Royal Commission on Co-Operatives, Ottawa 1945, p. 53.
Report of the Royal Commission on Taxation, Ottawa 1967, Tome 4, Chapiter 20.

2. In ordinary corporate organization the right to vote is in relation with the number of shares held by the shareholder. In a Caisse populaire, voting is on a personal basis, according to the accredited co-operative principle : " one member, one vote ".

3. In ordinary corporate organization, the operation net profits appropriated to the surplus are distributed to the capital as dividends. In the Caisse populaire, which is a co-operative association, interest on the capital is limited and the operating surplus, after having provided for the reserve funds are distributed to user-members proportionately to their business transacted with the Caisse populaire (sec. 4d of our Act).

4. In ordinary corporate organization, surpluses may be divided in part or in whole among the shareholders. In a Caisse populaire, reserve funds may not be divided neither in whole nor in part among the members (sec. 86 of our Act). Even in the case of a winding-up in no way can they be appropriated by the members and the section 95 stipulates that " the balance of the proceeds of the assets shall be distributed in the territorial division among one or more works of general utility designated by the Lieutenant-Governor in Council ".

5. In ordinary corporate organization, the share capital may incur a capital gain. In the Caisses populaires, there is no possibility at all of a capital gain on the capital stock paid by the members. This is explained by the characteristics already described. In a corporation the capital gain comes from the expectation of future profits that will be distributed in return on a limited capital. The objective in a Caisse populaire

is not the profit but the service to members; moreover the capital stock is not limited and may be increased by the arrival of new members or by capital deposits from existent members. In all cases, the shares receive a limited interest.

We could elaborate on the economic and social role assumed by the Caisses populaires (the economic and social role assumed by the Caisses populaires has been described in our brief to the Carter Commission) but we believe, at this point, that we must limit our observations solely to the legal characteristics already pointed out. These characteristics clearly determine the co-operative nature of the Caisses populaires and differentiate their structure from the structure of the ordinary corporate organization.

B) Caisses populaires tax exempted

The Caisses populaires are tax exempted if they get their income principally from loans to members, or from bonds issued or guaranteed by the Government of Canada or of a province. This is the reason why practically all the Caisses populaires are tax exempted. It is understood that the employees of the Caisses populaires pay income tax on their salaries and that members pay income tax on the interests received on their savings and on their shares in their Caisse populaire, likewise the Caisses populaires pay real estate tax on their land and buildings. We must admit, however, that the amounts paid into the reserve funds are tax exempted.

We agree entirely with the Porter Commission's remarks to the effect that the rapid growth of the Caisses populaires and of the Credit Unions in not due to their being tax exempted. The Porter Commission feels that the rapid growth of the Caisses populaires and of the Credit Unions is determined rather by a sequence of other factors such as : [1)]

- They are to be found in Quebec in no less that 500 localities where there is no bank branch.
- They are conveniently located.
- They do business at hours which best suit their members.
- They offer mortgage and personal credit at attractive rates to people who might well be considered less credit worthy by institutions lacking such close personal knowledge of their character and financial position.
- Since long ago they offer life insurance coverage on loans and savings.
- They offer their members the right to share in the management of a common venture.
- The members feel more closely associated with their Caisse populaire or Credit Union than they do with a bank branch.
- In Quebec nationalistic and other social forces may be a factor in the growth of the movement.
- Finally, the fact that 50,000 Canadians give their time without pay to their Caisses populaires or to their Credit Unions is impressive evidence of the dedication and strong appeal which the movement engenders in its members.

1) Idem p. 162.

WHITE PAPER PROPOSALS

The White Paper proposes to treat Caisses populaires and Credit Unions as other co-operatives are treated for taxation (4.73). In order to try to understand the problem, we reproduce the paragraphs dealing with the co-operatives and we comment on the text. Explaining the actual taxation basis for the co-operatives, the White Paper notes that :

> 4.69 ...patronage dividends are deductible in computing the taxable income of the co-operative, subject to a limit. Patronage dividends are deductible before interest paid (....) but cannot reduce profits at that point in the computation below 3 per cent of capital employed. This might be thought to ensure that members are taxed on some return on their investment in the co-operative. However, the 3 per cent is far too low in current circumstances...
>
> 4.70 The government proposes that the interest rate be set in accordance with a formula comparable to the formula used to determine the rate on farm improvement loans, that is, the rate would vary from year to year depending upon the interest rates paid on government bonds. It is also proposed that only interest paid to members on their loans and capital be taken into account after the deduction of patronage dividends.
>
> 4.71 As a result, co-operatives (we read Caisses populaires) could continue to eliminate taxable income by a combination of patronage dividends and interest to members. However members would be taxable on a full commercial rate of interest on the investment which they have in the co-operative (we read Caisses populaires) provided of course the co-operative (we read Caisses populaires) earns that much before patronage dividends.

Commentaries :

1- Need of important general reserve

The White Paper taxation proposals do not take into consideration the fact that the Caisses populaires must build up important general

reserves in order to ensure their financial stability. The purpose of these general reserves is to offer greater solidity to these co-operative institutions owned by thousands of people of humble economic conditions who may at any time withdraw their savings and also to make up for the instability resulting from a fluctuating capital, since the shares composing it are in reality similar to savings deposits and may be withdrawn on demand or on very short notice. The reserve funds thus created which, with the capital stock, guarantee the savings, have the double advantage to procure a capital for the efficacity of the operation and to give confidence to members.

It must be remembered that the reserve funds of the Caisses populaires cannot be divided among members neither in whole nor in part, not even in a case of a winding-up. Furthermore these reserve funds never contribute to create a capital gain on shares. It is thus without any personal pecunary interest that the members accept to charge to the reserve funds of the Caisse populaire an important part of their annual operating surplus; they do so to ensure the solidity and perpetuity of their collective enterprise and to develop towards it the mutual confidence of present and future members.

The reserve funds of the Caisses populaires, estimated at $85 millions at the end of 1969, may, at first sight, seem considerable in comparison to the reserve funds of other financial institutions. Before making a judgment, it must be noted that the Caisses populaires not being effectively submitted to the tax legislation, their reserve funds include, without identifying them, the adjustments needed to revalue their assets in a manner admitted for income tax purposes.

We must finally point out that the Caisses populaires are all self-governing enterprises and that, being small local institutions primarily concerned to best serve the individual and collective interests of their members, they are affected by local problems: strikes, conflagration, depopulation, their locality economic hazards, etc. For this other reason the Caisses populaires owe it to themselves to have important reserves.

The Caisses populaires must continue to be able to appropriate to their general reserves an important part of their annual operating surplus without being submitted to a taxation that would be unfair. The White Paper, unfortunately, did not elaborate in that sense; it does not mention the taxation rate that might be applied to these amounts paid into the reserves nor of the possible integration of that income tax to the income tax of the members.

2- In the Caisses populaires, patronage dividends are paid ultimately

The paragraph 4.69 of the White Paper does not respect the method of distribution of the Caisses populaires annual operating surplus. The Caisses populaires usually distribute their operating surplus in the following way :

First they pay into their reserves a part of their surplus earnings. The law compels us (sec. 86) to pay at least 10% of our operating surplus into reserve funds. By ruling of their internal management, the Caisses populaires have decided to pay at least 30% of their operating surplus into these funds; in practice they have deemed it necessary to pay into the funds a little more than 40%.

Secondly they look for a suitable and reasonable remuneration of the capital stock paid by their members. Interest rates paid by the Caisses populaires are usually competitive with the interest rates offered by the financial market for the savings personally withdrawable over the counter only.

Finally, if they can do so, they distribute an added interest to the depositors and/or a patronage refund to the borrowers to the extent it is judged opportune by the general meeting.

Distribution of the operating surplus of the Caisses populaires

	Fiscal year 1967		Fiscal year 1968	
Paid to reserves	$ 6,044,000.	44%	$ 7,507,000.	43%
Dividend on capital stock	7,036,000.	51%	9,014,000.	52%
Added interest on savings	294,000.	2%	509,000.	3%
Patronage refund on loans	361,000.	3%	411,000.	2%
Total of operating surplus	$ 13,735,000.	100%	$ 17,441,000.	100%

3- Uncertain notion of the capital employed

The notion of the capital employed developed in the White Paper is not explicit for the co-operatives; it is farless explicit for the Caisses populaires. Does the capital employed include only the capital subscribed by the members ? Must we include reserves in this notion of the capital employed ?

4- Obligation to bear a fixed rate of return

The Caisses populaires should yield to their members a fixed rate of return, variable " in accordance with a formula comparable to the formula used to determine the interest rate on farm improvement loans " (4.70). If the Caisse populaire does not yield the fixed rate of return, the paragraph 4.71 tells that " the members would be taxable on a full commercial rate of interest on the investment which they have in the co-operative (we read Caisse populaire) (provided of course the Caisse populaire earns that much before patronage dividends). "

This obligation that the Caisses populaires would have to yield a minimum return on the capital employed seems to us alarming in itself. It is more so alarming when we realize that this minimum return is similar to the return on farm improvement loans, which is actually 8½%.

a) To our knowledge no other institutions is under law obligation to yield a minimum return on its capital or on deposits received. On the contrary we usually encounter a legislation fixing a maximum rate of interest which financial institutions may offer for different kinds of deposits. Example: In the United States, the commercial banks, the State banks, the Savings and Loans, the Trust companies are all subject to laws setting the maximum rate of interest they may offer for different forms of demand or term deposits.

b) The co-operative philosophy has always established that the capital stock should receive a limited return. This

preoccupation of the co-operatives has been recognized by the provincial legislators who made the laws governing us, these laws stipulate that the interest on shares is limited or again deem a maximum rate of interest (usually 6%) above which the capital stock could not be remunerated. The approach of the White Paper overlooks this co-operative preoccupation respected and confirmed by the provincial legislators.

c) The present taxation of the co-operatives based on a fixed rate of return on their capital employed appears to us as the result of a political compromise and not as the result of a serious and logical study. Nowhere else can this taxation principle be found. Professor R. Graig McIvor has very well precised this idea in his book[1)] RECENT GROWTH IN CANADIAN CO-OPERATIVES. He writes " it is difficult to defend in principle the present proposal that minimum taxable income be raised, say to six per cent, in conformity with current long term interest rates". Further ahead he adds : " If the taxation of co-operatives is deemed by competitors to be inequitable, the remedy may be sought more rationally elsewhere ". Though written in 1961 Professor McIvor's text is still of actuality.

d) Finally, this notion of return on the capital employed is still more alarming when we realize that the fixed rate of return would be at the rate of the farm improvement Act!

1) McIvor, R. Graig, Recent Growth in Canadian Co-Operatives, Toronto, Canadian Tax Foundation, 1962, p. 34.

(i) The Caisses populaires being deeply involved in loans for farm improvement, their assets would include a number of loans for that purpose yielding 8½% maximum interest, whereas their liabilities should yield the same rate of return on the capital employed. Who is going to pay for the management of these loans and of this capital ? The problem is even more complex than that for the books of the Caisses populaires carry a number of loans for farm improvement, made from January 1962 to June 1968 and bearing presently an interest of 6% only; their loans for farm improvement made between June 1968 and April 1970 bear 7½% interest. Loans made after April the first 1970 only will bear 8½% interest. Soon the books of the Caisses populaires will carry three categories of loans for farm improvement; the most important category will yield 6% interest, the second one will yield 7½% interest and lastly the least important category (because it begins in April 1970) will yield 8½% interest. And it would be required that all the capital employed would yield 8½% interest ?

(ii) As a matter of fact the Caisses populaires in Quebec lend by virtue of the Quebec Farm Improvement Act. If, as impossible as it seems, they should be taxed on a return on their capital employed computed at the rate of interest on farm improvement loans, which rate of interest should be

(ii) used, the rate of interest deemed by the Federal Farm Improvement Loans Act or the rate of interest deemed by the Quebec Farm Improvement Act ? It is known that these two Acts do not necessarily specify the same rates ....

(iii) If the Caisses populaires were compelled to give such a high rate of interest on their capital employed, they would set themselves completely outside of the market rates and would find themselves offering a much higher rate of interest than other financial institution for similar savings, that is to say repayable on demand.

In short, the taxation proposals made in the White Paper to tax the Caisses populaires seem inadequate to us for two principal reasons :

1 - They forget that the Caisses populaires must build important general reserves to assure their security in view of the variable character of their capital stock.

2 - The taxation proposals are based on a complicated notion of return on a capital employed, a notion that is nowhere else used and which comes more from a political compromise than from a logical analysis. The return deemed on this capital employed is much too high. It does not respect the co-operative philosophy confirmed by the legislation of the different Canadian provinces. It is by far superior to the rates offered by different financial institutions on similar forms of savings.

SEARCHING FOR A SOLUTION

The Caisses populaires want to emphasize that they are in accordance with the basic principle of the Carter Commission reiterated in the White Paper that income of enterprises should be taxed once only and at the rate of the individual to whom this income belongs.

Partnership option ?

According to the basic principle already mentioned, we find equitable the treatment offered to small corporations to be dealt with as partnership enterprises. In that case, the corporation does not pay any corporation tax at all but shareholders pay personal tax on their share of the corporation's profits. In order to receive such a treatment, the corporations must however respect four rules :

1) All their shareholders must sign for the election of such a treatment (4.22).
2) What portion of profits each shareholder is going to receive must be clearly established.
3) Shareholders must be strictly Canadian residents.
4) If a portion of the shares are held by Canadian Corporations, those corporations must have the same fiscal year as the corporation itself (4.23).

Even if all the members of the Caisses populaires are Canadian residents, the Caisses populaires could hardly be classed as partnership corporations. Due to the great number of their members it would be difficult for the Caisses populaires to obtain the signature of them all and it would be unmanageable to establish beforehand the portion of the operating surplus for each member.

Furthermore, we must recognize that the Caisses populaires fiscal year-end does not necessarily coincide with the fiscal year-end of the Unions régionales federating them.

Closely held corporation ?

The Caisses populaires should qualify to be considered as closely held corporation.

- Shares not transferable.

The Caisses populaires do not have their shares listed on the stock market, not even outside their premises. Moreover the share that confers the privilege of ownership is personally owned by the member shareholder and the quality of a member of the Caisse populaire cannot be transferred to another person.

- Limited territorial jurisdiction

The Caisses populaires are not of an international nor national calibre; their territorial jurisdiction of operations does not usually exceed the limits of a parish or of a city.

- Participation

The Caisses populaires are community enterprises integrated to the society then belong to, in return the members of the community participate to the Caisse populaire activities. In Quebec, more than 40% of the total population are members of the Caisse populaire, not counting the

nearly 500,000 school depositors. During 1969, the members deposited $ 5,992 millions at their Caisse populaire and they withdrew $ 5,831 millions; for each dollar deposited only 2.7 cents remained. During the same year 1969, about 1 member out of 8 obtained a loan from his Caisse populaire. As of December 1969, members of the Caisse populaire had an average of $76. in capital stock and $652. in savings per member; at the same date, the average value for outstanding personal loans was $963. whereas the average value for outstanding mortgage loans was $ 5,489. All these figures prove that the members of the Caisses populaires are and feel associated to their savings and credit co-operative and that they use its services. Finally, we must note that, in Quebec only, about 20,000 members give their time without pay to their savings and credit unions as supervisor, credit commissioner or member of the board of directors.

For all these reasons the Caisses populaires must be considered as closely-held corporations. They could not, in any way, be assimilated to widely-held corporations.

The taxation treatment for closely-held corporations proposes that " they would have to pay a tax of 50 per cent on the taxable income of the corporation. However when the net profits are distributed to the shareholders, credit would be given for the full amount of the tax paid by the corporation on those profits " (4.24). Section 4.27 stipulates that dividends may be paid in shares...

If the Caisses populaires were to be treated as closely-held corporations for tax purposes two major problems would result from this treatment : a management problem and a cash flow problem.

A. Management problem.

The management problem would arise from the massive processing of T-5 and TP-5 forms it would necessitate. In Quebec only in order that the income tax paid by the Caisses populaires may be passed to members for integration with personal tax a processing of about 2,500,000 T-5 and TP-5 forms would be necessary. (At the Canadian level a processing of T-5 forms in excess of 5 millions would be required by the Caisses populaires and the Credit Unions). The Federal and Provincial income tax services will then have to reprocess these T-5 and TP-5 forms for analysis and income tax return purposes.

We are well aware that we already provide our members, receiving $10.00 and more in interest on savings and dividend on shares, with T-5 and TP-5 forms. But only 28% of our members earn such an interest; they receive though 87% of the total amounts in interest on savings and in dividend on capital stock paid by the Caisses populaires. If we had to provide all our members with T-5 and TP-5 forms, the major number of these forms would show minimal amounts. Just the same it would be quite onerous to provide these forms; a minimum cost of ½ million dollars is estimated for the Quebec Caisses populaires only.

B. Cash flow problem.

The ordinary corporate organizations treated as closely-held corporations after having paid their income tax for their shareholders may distribute the remaining 50% of their taxable income in dividends stocks.

If they use this distribution method they are sure to be able to keep the 50% of their net profits in their enterprise, for the capital stock is usually unredeemable by a corporation. It is not so for a Caisse populaire where the capital stock is redeemable on demand. Furthermore, it is known that contrary to an ordinary corporate organization the capital stock of a Caisse populaire does not rule the right of voting, it is not the only distribution basis of the future operating surplus and does not allow capital gain. For these reasons the Caisses populaires could not count on increasing the equity of their members, in a permanent way, as in a share company, by distributing in capital stock 50% of their operating surplus.

If the Caisses populaires are to be allowed to increase the equity of their members in a permanent way, they must also be allowed to develop their general reserves. As these reserves are undivisible and never incur a capital gain on the capital sotck, they will never cause a taxation evasion.

PROPOSED SOLUTION

After a thorough study of the different measures of taxation treatment offered in the White Paper to different kinds of enterprises in Canada, we support the brief presented jointly by the Co-operative Union of Canada and Le Conseil Canadien de la Coopération to ask that, between the treatment as a partnership corporation and the treatment as a closely-held corporation, provisions should be made for a specific treatment for the " collectively-held corporations" or co-operatives which would respect the principles of the International Co-operative Alliance.

This taxation treatment offered to collectively-held corporations or co-operatives would not show favouritism. It would be an equitable treatment respecting both the characteristics of co-operative corporations and the basic principle of the Carter Commission and of the White Paper stipulating that income of enterprises should be taxed once only and at the rate of the individual to whom this income belongs.

The taxation treatment for co-operative corporations should recognize two rules :

1. Co-operative enterprises could eliminate taxable income by paying their members interests or patronage refunds with their operating surplus.

2. The portion of operating surplus paid into the reserve of these collective enterprises would be taxed in the hands of the enterprise at a collective average rate of tax of their members.

A) Elimination of taxable income.

Section 4.71 of the White Paper already recognizes that " co-operatives could continue to eliminate taxable income by a combination of patronage dividends and interest to the members ".

However the co-operatives should not be asked to give a minimum return on the capital paid by the members. The co-operative enterprises are already preoccupied to pay a reasonable return on this capital. Even if they did not have this preoccupation we are convinced that the law of supply and demand and the competitive forces would be sufficient enough to oblige the co-operative corporations to appropriately remunerate their capital. In practice the Caisses populaires already pay a competitive rate of interest on their capital stock and there is no tax evasion there. As of January the 31st 1970, the weighted average return rate on the capital stock was 6.13%.

B) Sums paid into reserves taxable at a collective average rate.

The purpose of this rule is to allow the government to obtain the same income tax return as if the sums paid into the reserves had been distributed to the members while permitting the collective enterprise to set up general reserves from its operating surplus.

We acknowledge it would be difficult to establish an average rate of tax for the members of each collective enterprise. To avoid this problem we would accept that the sums paid into the reserves be taxable at the average personal provincial rate of tax of the province in which the

co-operative carries on business. By accepting this average provincial rate we are aware that the co-operative enterprises would be slightly more taxed than if they would use the average rate of tax of their members; it is well known that co-operatives develop within the workingclass and that they rarely overtake the well-to-do classes of the society.

Taxation at a collective rate on the sums paid into the reserves would avoid the processing and analysis of T-5 and TP-5 forms for all our members as income tax being already collectively integrated, there would be no need for it to be personally integrated.

This collective rate of tax very well respects the collective character of the reserves of the Caisses populaires as their reserves are owned by the institution, a collective propriety of the members, and as they can never be distributed to the members even in the case of a winding-up of the Caisse populaire.

PROVISIONS FOR DOUBTFUL DEBT RESERVES AND LIQUIDITY RESERVES

The White Paper proposes to grant to the Caisses populaires and Credit Unions, as to the banks, deductions for doubtful debt reserves and liquidity reserves (4.73).

If the Caisses populaires are to be taxed, it is quite normal that they may set up, from their future taxable income, provisions for their doubtful debt reserves and liquidity reserves comparable to those permitted in the banking system.

These provisions for doubtful debt reserves and for the fluctuation of the value of investments could not be assimilated to the existing general reserves actually in the Caisses populaires. The present general reserves of the Caisses populaires are collectively owned by their members; even though they are undivisible they can be compared to the rest accounts of the chartered banks which are the property of the shareholders. We want to specify that the Caisses populaires did not set provisions for doubtful debt reserves and liquidity reserves as provided by the income tax legislation. To want to assimilate their general reserves to provisions for doubtful debt reserves would give a retroactive character to the taxation proposed in the White Paper. Presently, retroactive taxation is never mentioned in the Proposals for Tax Reform of the Federal Government.

If the Caisses populaires are to be taxed they will have to readjust their accounting procedures in view of taxation. This would not be a simple operation, as it concerns a movement composed (for the Caisses populaires affiliated to the Fédération de Québec only) of 1310 autonomous enterprises carrying business with their own accounting for many decades. A transition period to establish procedures permitting especially a reevaluation of the assets will surely have to be provided for.

CONCLUSIONS

The Caisses populaires are economic agents at the service of their members. Being strictly a juridical intermediary between the lender members and the borrower members, the operating surplus made do not belong to them but are individually or collectively owned by their members. This is the reason why they have always refused and are still refusing to be taxed as enterprises different from their members.

The Caisses populaires have always recognized the fact that they are a source of income for their members and that this income is taxable in the hands of the members. They want to emphasize that they are in accordance with the basic principle of the Carter Commission reiterated in the White Paper, that income of enterprises should be taxed once only and at the rate of the individual to whom this income belongs.

The specific taxation treatment proposed to the Caisses populaires does not fit in the background of the Proposals for Tax Reforms provided for the corporations and their shareholders. Oriented by a heteroclite notion of high return on the capital employed, this specific taxation treatment raises more problems than it solves them; it completely ignores the fact that the Caisses populaires must create for themselves general important reserves to ensure their stability in consideration of their popular character attested by the multiplicity of their members totalizing 2,500,000 in Quebec, and in consideration of the modest character of the savings they constantly use.

We associate ourselves with the Co-operative Union of Canada and the Conseil Canadien de la Coopération in their joint presentation of their brief requesting that the co-operative corporations which are collective corporations be granted a taxation treatment respecting at the same time their characteristics and the principle that income of enterprises should be taxed once only at the rate of the individual to whom this income belongs. With this taxation treatment the Caisses populaires could continue to distribute the major part of their operating surplus in dividends or in interests on the capital stock or on savings and in patronage refunds; and their sums paid into the reserves would be taxable at the average individual rate of tax in Quebec.

We have been pleased to respectfully submit you these constructive proposals hoping they will be examined in the same spirit of equity and in seeking the welfare of the community which is guiding us in making them.

Emile Girardin
President

Paul-Emile Charron
General Manager

LA FÉDÉRATION DE QUÉBEC DES UNIONS RÉGIONALES DES CAISSES POPULAIRES DESJARDINS

J. Romuald Paiement
President

André Lamarche
General Manager

LA FÉDÉRATION DE MONTRÉAL DES CAISSES DESJARDINS

Avila Bourbonnais
President

Robert Soupras
General Manager

LA FÉDÉRATION DES CAISSES D'ÉCONOMIE DU QUÉBEC

APPENDIX "K"

NAME: Joint Presentation of

LA FEDERATION DE QUEBEC DES UNIONS REGIONALES DES CAISSES POPULAIRES DESJARDINS

LA FEDERATION DE MONTREAL DES CAISSES DESJARDINS

LA FEDERATION DES CAISSES D'ECONOMIE DU QUEBEC

Analysis of Appendix "J" by Senior Advisor

COMMENTS OF ADVISOR

"The brief was prepared by La Federation de Quebec des Unions regionales des Caisses populaires Desjardins, grouping in Quebec 1310 Caisses populaires, owned by 2,375,000 members. As of December 1969, the total assets of these 1310 Caisses populaires amounted to $1,854,000,000.

Even though the figures mentioned in this brief refer solely to the Caisses populaires affiliated to the Federation de Quebec des Unions regionales des Caisses populaires Desjardins, two other federations of savings and credit unions express their agreement with the content of this brief and join the Federation de Quebec in presenting it. The federations concerned are: La Federation de Montreal des Caisses Desjardins grouping 33 Caisses populaires owned by 150,850 members with total assets of $161,697,000. as of December the 31st 1969, and La Federation des Caisses d'Economie du Quebec grouping 195 Caisses d'economie owned by 120,720 members with total assets of $74,657,000. as of December the 31st 1969. The three federations mentioned above represent 95% of the savings and credit unions operations in Quebec.

The Caisses populaires are savings and credit co-operatives at the service of its user-members. Up to now they were tax exempted on their annual operating surplus paid into the reserve funds. The Caisses populaires though

not in accordance with the special treatment offered them in the White Paper in regard to the proposals for tax reform, are nevertheless in accordance with the general proposals for integration provided in this White Paper. To that effect, they subscribe to the proposals made jointly by the Co-operative Union of Canada and the Conseil Canadien de la Cooperation, requesting, in their brief, that the cooperatives may be granted a personal taxation treatment respecting at the same time the basic principles of Minister Benson's White Paper and the basic principles of the cooperative associations."

The brief itself comprises the following sections:

(1) A description of a Caisse populaire. (Pages 3 to 6).

(2) A commentary on the White Paper proposals as contrasted to the financial requirements of a Caisse populaire. (Pages 7 to 19).

(3) A proposed alternative to the White Paper proposals. In brief, this solution would require the recognition of two rules being:

"Co-operative enterprises could eliminate taxable income by paying their members interests or patronage refunds with their operating surplus."

"The portion of operating surplus paid into the reserve of these collective enterprises would be taxed in the hands of the enterprise <u>at a collective average rate of tax of their members</u>." (Pages 20 to 22).

(4) A section dealing with provisions for doubtful debts and reserves. (Pages 22 and 23).

(5) A summary of recommendations

The summary of the recommendations follows:

"The Caisses populaires are economic agents at the service of their members. <u>Being strictly a juridical intermediary between the lender members and the borrower members</u>, the

operating surplus made do not belong to them but are individually or collectively owned by their members. This is the reason why they have always refused and are still refusing to be taxed as enterprises different from their members.

The Caisses populaires have always recognized the fact that they are a source of income for their members and that this income is taxable in the hands of the members. They want to emphasize that they are in accordance with the basic principle of the Carter Commission reiterated in the White Paper, that income of enterprises should be taxed once only and at the rate of the individual to whom this income belongs.

The specific taxation treatment proposed to the Caisses populaires does not fit in the background of the Proposals for Tax Reforms provided for the corporations and their shareholders. Oriented by a heteroclite notion of high return on the capital employed, this specific taxation treatment raises more problems than it solves them; it completely ignores the fact that the Caisses populaires must create for themselves general important reserves to ensure their stability in consideration of their popular character attested by the multiplicity of their members totalizing 2,500,000 in Quebec, and in consideration of the modest character of the savings they constantly use.

We associate ourselves with the Co-operative Union of Canada and the Conseil Canadien de la Cooperation in their joint presentation of their brief requesting that the co-operative corporations which are collective corporations be granted a taxation treatment respecting at the same time their characteristics and the principle that income of enterprises should be taxed once only at the rate of the individual to whom this income belongs. With this taxation treatment the Caisses populaires could

continue to distribute the major part of their operating surplus in dividends or in interests on the capital stock or on savings and in patronage refunds; and their sums paid into the reserves would be taxable at the average individual rate of tax in Quebec."

Name: JOINT PRESENTATION OF CAISSES POPULAIRES

Principal Subject: BAD DEBT AND SOLVENCY RESERVES

Present Tax Law	White Paper Proposals	Principal Points of Brief
Section 62-1-k of the Income Tax Act This section exempts from tax the income of Caisses Populaires that meet certain qualifications.	4.72 These organizations, which are co-operatives operating in the financial field, are specifically exempt from income tax under the present legislation. Originally caisse populaires and credit unions were small organizations serving limited groups of people basically on a non-profit basis. However, with the increased scope of their activities and operations, some of them are in real competition with other financial institutions. 4.73 The government proposes to treat caisse populaires and credit unions as other co-operatives are treated. They would of course be granted deductions for doubtful debt reserves and market liquidity reserves comparable to those allowed to banking institutions.	Pages 22 and 23 of Brief This portion of the brief states: "These provisions for doubtful debt reserves and for the fluctuation of the value of investments could not be assimilated to the existing general reserves actually in the Caisses populaires. The present general reserves of the Caisses populaires are collectively owned by their members; even though they are undivisible they can be compared to the rest accounts of the chartered banks which are the property of the shareholders. We want to specify that the Caisses populaires did not set provisions for doubtful debt reserves and liquidity reserves as provided by the income tax legislation. To want to assimilate their general reserves to provisions for doubtful debt reserves would give a retroactive character to the taxation proposed in the White Paper. Presently, retroactive taxation is never mentioned in the Proposals for Tax Reform of the Federal Government.

Name: JOINT PRESENTATION OF CAISSES POPULAIRES

Principal Subject: BAD DEBT AND SOLVENCY RESERVES

Present Tax Law	White Paper Proposals	Principal Points of Brief
		If the Caisses populaires are to be taxed they will have to readjust their accounting procedures in view of taxation. This would not be a simple operation, as it concerns a movement composed (for the Caisses populaires affiliated to the Fédération de Québec only) of 1310 autonomous enterprises carrying business with their own accounting for many decades. A transition period to establish procedures permitting especially a reevaluation of the assets will surely have to be provided for."

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 26

THURSDAY, MAY 21st, 1970

Twentieth Proceedings on the Government White Paper,

entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 26:5)

APPENDICES:

"A"—Brief from Massey-Ferguson Limited.
"B"—Brief from the Canadian Federation of Agriculture.
"C"—Brief from The League of Concerned Canadians.
"D"—Brief from the Montreal Kiwanis Club Inc.

22085—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Desruisseaux	Kinley
Aseltine	Everett	Lang
Beaubien	Gélinas	Macnaughton
Benidickson	Giguère	Molson
Blois	Grosart	Phillips (*Rigaud*)
Burchill	Haig	Walker
Carter	Hayden	Welch
Choquette	Hays	White
Connolly (*Ottawa West*)	Hollett	Willis—(30)
Cook	Isnor	
Croll		

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

22085—1½

MINUTES OF PROCEEDINGS

THURSDAY, May 21st, 1970.
(39)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Benidickson, Burchill, Carter, Connolly (*Ottawa West*), Desruisseaux, Gélinas, Haig, Hollett, Isnor, Kinley, Macnaughton, Molson, Phillips (*Rigaud*) and Welch—(17).

Present, but not of the Committee: The Honourable Senator Smith—(1).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

WITNESSES:

Massey-Ferguson Limited.

Mr. P. N. Breyfogle, Comptroller;
Mr. J. P. Wleugel, Treasurer;
Mr. M. J. Ellis, General Tax Manager;
Mr. R. MacLaren, Assistant to Vice President, Public Relations;
Mr. R. Snelgrove, Senior Solicitor.

Canadian Federation of Agriculture.

Mr. C. Munro, President;
Mr. D. Kirk, Executive Secretary;
Mr. M. Davidson, Director and Member of Executive, Ontario Federation of Agriculture.

League of Concerned Canadians.

Mr. C. C. Locke, Q.C., Chairman;
Mr. R. Keyes, Economist.

At 12:00 Noon the Committee adjourned.

AFTERNOON SITTING

1:30 p.m.
(40)

At 1:30 the Committee *resumed.*

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Benidickson, Burchill, Carter, Connolly (*Ottawa West*), Desruisseaux, Gélinas, Haig, Hollett, Isnor, Kinley, Macnaughton, Molson, Phillips (*Rigaud*) and Welch—(17).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

Montreal Kiwanis Club Inc.

Mr. J. R. Flummerfelt, Vice President, Kiwanis Club of Montreal;
Mr. R. B. Allen, Governor, Kiwanis Clubs, Ontario, Quebec, Maritimes;
Mr. W. Desnoyers, Lieutenant Governor, Kiwanis Clubs, Ontario, Quebec, Maritimes, District 15;
Mr. Benoit Parent, Past District Governor, Optimist International;
Mr. Edward Twizell, Past President—Montreal Rotary Club;
Mr. Sydney Benjamin, Governor of Inter-Service Clubs Council (Montreal).

* The Honourable Senator Phillips (*Rigaud*) assumed the Chair as *Acting Chairman.*

Ordered: That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from Massey-Ferguson Limited.
B—Brief from the Canadian Federation of Agriculture.
C—Brief from The League of Concerned Canadians.
D—Brief from the Montreal Kiwanis Club Inc.

At 3:00 p.m. the Committee adjourned to the Call of the Chairman.

ATTEST:

Frank A. Jackson.
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Thursday, May 21, 1970

The Standing Senate Committee on Banking, Trade and Commerce met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Hon. Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: I call the meeting to order. We have a number of briefs before us this morning. We will hear the Massey-Ferguson brief first, and then the brief of the Canadian Federation of Agriculture, after which we will hear the League of Concerned Canadians, and then the Montreal Kiwanis Club.

I propose to adjourn this morning's session at 12 o'clock because some members of the committee have other duties to perform at that time. We will resume at 1.30 and at 2 o'clock there will be a recess of five minutes so that the members of the committee will be able to attend in the Senate chamber.

We have representing Massey-Ferguson Limited a delegation headed by Mr. P. N. Breyfogle, the Comptroller. Mr. Breyfogle, will you present your panel, and then make your opening statement?

Mr. P. N. Breyfogle, Comptroller, Massey-Ferguson Limited: Thank you, Mr. Chairman, I should like to open by saying that we are very grateful for this opportunity to discuss with you our views on the tax reform proposals, and I should like to start by introducing the other members of the company who are here with me. On my right is Mr. Martin Ellis, our General Tax Manager. Next to Mr. Ellis is Mr. John Wleugel, the company's treasurer, and beside him is Mr. Roy MacLaren, the assistant to the Vice President, Public Relations. At the far end is Mr. Robert Snelgrove, who is the general counsel for the company in Canada.

As we have noted in our brief we have concentrated our comments on the international aspects of these proposals. We should like to emphasize that Massey-Ferguson's operations here in Canada are nevertheless very substantial, with M-F Industries' sales, including exports, exceeding $170 million in 1969. However, the parent company of the group, Massey-Ferguson Limited, occupies a special position in that it is one of very few Canadian companies. A majority of shares are held by Canadians, but very substantial operations and investments are located abroad. We decided, therefore, that it would be most useful to direct our comments particularly to those aspects of the proposals that affect Canadian companies with foreign subsidiaries. We shall, however, also be pleased to discuss with you our views on the purely Canadian aspects of the tax reform proposals, if you would find that helpful.

In the proposals concerning international income, the White Paper recognizes explicitly four objectives:

> 1. The Canadian tax system should not encourage nor discourage foreign investment by Canadians.
>
> 2. Canadian companies competing in foreign markets should not be subject to more onerous taxes than their competitors.
>
> 3. Canada should promote a climate hospitable to the unrestricted flow of capital across international boundaries.
>
> 4. Canadian tax laws should not permit fraudulent avoidance of Canadian tax through artificial arrangements.

These objectives appear logical and reasonable. However, we find the White Paper's proposals are, in fact, in basic conflict with three of its own objectives. The only principle that is given real recognition is the fourth, the anti-avoidance objective.

Today's economic environment is rapidly shrinking in terms of space and time. The last two decades have established beyond doubt that no national economy can afford to stand in isolation. Multinational corporations are responsible for an increasing amount of inter-

national trade. Failure to invest in a foreign market may result in the loss of that market, eliminating not only export sales, but eliminating also the source of income that would have flowed from that investment. It would also impair in the long run the ability of Canadian companies to compete even in Canada. Foreign-based companies with their international volume potential will be much better able to keep pace with technological change, and will benefit from the economies of scale. Canada must take great care to ensure that a reasonable number of the world's multinational corporations are Canadian. Otherwise, Canada will become a country of subsidiaires.

In view of these changes in environment, we believe that the Government should—as a matter of economic policy—stimulate foreign trade and foreign investment by Canadian individuals and corporations. Such encouragement might well be administered in part through the tax system. We believe that the opportunities opened by such encouragement would be extremely beneficial to the Canadian economy.

1. Despite the stated objectives of the White Paper, the actual proposals contain a strong disincentive for Canadians to invest abroad. The result of this inward-looking attitude may well be that the ownership of Canadian companies with substantial foreign operations may pass into foreign hands. This would be primarily the result of the proposal to integrate corporate and personal tax. It is only one of the many unfavourable aspects of this proposal outlined in our brief. We accordingly recommend that the existing dividend tax credit, increased as to rate and with some minor amendment, could achieve the White Paper's domestic and international objectives in a much better way. However, even if integration is adopted, we recommend that appropriate relief is given to the Canadian shareholder on dividends with significant foreign content to avoid the undesirable effects I have just mentioned.

2. The desire to eliminate fraudulent Canadian tax avoidance has led to proposals with much broader scope which will further discourage Canadians from investing abroad. The proposed two restrictions on the tax exemption of foreign dividends will jeopardize Canadian competitiveness by imposing a heavy tax penalty not suffered by our foreign competitors. These restrictions will impose a very heavy administrative burden on both Government and taxpayers to an extent totally unwarranted by the objective sought. We cannot accept anti-avoidance proposals as a motive for eliminating the dividend exemption for non-treaty country subsidiaries.

As far as the passive income proposals are concerned, we feel that the tax avoidance referred to is not simply due to imperfect legislation and it could be substantially eliminated by administration change. We have in our brief suggeted that by stricter enforcement of existing law, with, if necessary, some legislation designed to deal specifically with avoidance of Canadian tax, Canada could achieve the objective without the injurious impact on bona fide international companies.

3. Several of the White Paper proposals, in particular those on integration, capital gains and withholding taxes, will jeopardize Canada's chances of negotiating meaningful tax agreements even with our current treaty partners. The Government has recognized that the White Paper proposals will not be workable unless and until Canada concludes a vast network of treaties. Unfortunately, the White Paper's attitude to international taxes is not conducive to free international capital flows. This will again discourage Canadians from participating in international trade and finance.

4. So far, we have been reviewing the impact of the White Paper proposals on the foreign operations of Canadian companies, both with regard to the company's growth and earning ability and Canadian shareholders of such companies. We should like to mention that two White Paper proposals concerning personal taxation would have a very detrimental impact on the development of all sectors of the Canadian economy. First, the proposal to increase Canadian taxes, particularly on the middle incomes, to a level far in excess of the United States, cannot but impair Canada's ability to attract and keep foreign and Canadian qualified managerial personnel. Secondly, the proposed deemed realization of capital gains upon departure from Canada would effectively prevent Canadians from going abroad to develop foreign markets for their products and services. It would deny Canadians the opportunity of seeking international experience which can be crucial to Canada's ability to compete in world markets. This is another example of how the desire to prevent isolated cases of tax evasion has resulted in proposals that disregard the requirements of the bona fide business com-

munity, with serious implications for Canada's growth and development.

These are the major areas in which we feel the White Paper proposals fall considerably short of achieving its objectives. They would introduce a series of side effects that cannot have been intended.

In closing, I would like to summarize our recommended modifications to the proposals:

1. Integration should be rejected in favour of the existing dividend tax credit system, with some modifications.

2. Even should integration be adopted, Canadian shareholders should be given credit for underlying foreign tax, as well as Canadian tax.

3. The tax exemption for dividends from foreign subsidiaries should continue without restriction.

4. Passive income proposals should be tailored to deal specifically with undersirable Canadian tax evasion.

These and some other modifications suggested in our brief would, in our opinion, present a better, more flexible and less burdensome approach in evolving Canada's tax system in a manner compatible with developments in the international business environment.

Senator Phillips (Rigaud): I know of three other Canadian companies that would fall within your category, such as the Moore Corporation, Walker and Seagram.

Could you give us an idea of any other major companies that fall within your category?

Mr. J. P. Wleugel, Treasurer, Massey-Ferguson Limited: Aluminum Company of Canada would be a typical example. There are Interprovincial Pipelines and Bata Shoes, but probably with a different setup.

Senator Phillips (Rigaud): Therefore, in addition to yourselves you represent a significant grouping of companies.

The next question is what proportion of your business is carried on outside of Canada?

Mr. Breyfogle: Roughly 7 to 8 per cent of our sales to third parties is carried on in Canada. Therefore 92 per cent or 93 per cent is outside.

However, Canada represents a major manufacturing source for the company and we have very substantial exports, bringing the total business of our Canadian activities up to $170 million last year. It has been over $200 million in previous years.

Senator Phillips (Rigaud): On the assumption that we abandon integration, with all its difficulties, what modifications do you suggest in the present system, which allows you to bring in your dividend income tax free?

I thought you said that on the assumption that integration is abandoned there should be some modifications to the present system.

The Chairman: They really suggest foreign tax credits.

Senator Phillips (Rigaud): No, but without the integration system we now have the dividend income from subsidiaries where you have a 25 per cent interest or more coming in tax free.

Are you suggesting any modification to that system?

Mr. Breyfogle: Our recommendation in the event that integration is implemented is that we continue with the existing dividend tax credit system, with modified amounts if appropriate.

Senator Phillips (Rigaud): No, leave out the integration for the moment. At present, as I understand it, we have a flexible system, pursuant to which foreign investments are encouraged in the sense that when dividends come in from subsidiaries or companies in respect of which you have a 25 per cent or more interest you receive exempt income. Then the recipient shareholder in Canada pays his tax in due course and the non-resident shareholder is subject to withholding tax.

Mr. Breyfogle: Yes, we are content with the present system. We find it is a satisfactory one in which an international company can carry on its business with a Canadian domicile.

The Chairman: The catch, Senator Phillips, in the White Paper is that the continuance of the present system on this point of dividends moving from a subsidiary outside Canada to the parent company in Canada free where they hold 25 per cent is that it is subject to the negotiation of a tax treaty.

Senator Phillips (Rigaud): Yes.

The Chairman: I understood the witness to say that the company's view of the possibility

of many meaningful tax treaties is something that is difficult to assess.

Senator Phillips (Rigaud): Yes. My observations were laying the foundation for this question. After all, you are one of our important world companies based in Canada.

How do you feel about the effect of an integration plan generally on the economy of our country? Do you think that, compared to what we now have, it is a system that we should introduce?

Mr. Breyfogle: We feel quite strongly that such a system should not be introduced.

In our view the introduction of a form of capital gains tax eliminates the need to provide any incentive for companies to pay out dividends in order to avoid non-taxable capital accumulations, and that integration by forcing companies to pay out dividends will substantially reduce their ability to grow, and in the long run will damage the Canadian economy to a significant extent.

Senator Phillips (Rigaud): The next question I would like to put to you is with respect to one of the four objectives in respect of which you say the White Paper is inconsistent, and that is the problem of offshore companies and siphoning of profits. Have you any suggestion how the committee might deal with that? In other words, what should be the test of the legitimacy of an offshore operation? Should it be one where the existence of the offshore company is necessitated by the domestic laws of the country in which the company, the subsidiary, operates, in which event it would eliminate holding companies or agency companies, or anything of that kind? Or what other guide can you give us for legitimacy in respect of offshore operation?

Mr. Breyfogle: I would like to ask Mr. Ellis to speak to this.

Mr. M. J. Ellis, General Tax Manager, Massey-Ferguson Limited: I think first of all the Canadian tax laws should concern themselves only with those cases where there is Canadian tax avoidance, perhaps sought or perhaps achieved. I do not think that Canadian tax laws should come into play at all where the operations of the offshore company have no impact whatsoever on Canada's revenue. The basic tests of legitimacy of an offshore operation are, I think, already in the Income Tax Act, particularly in section 17, which lays down the armslength standard, and in several other sections, of course, where there is also this approach. I think this is proven in many countries to be the only real handle that the Department of National Revenue can get on this slippery ball, if you like. This is what we have outlined in our brief.

We have also said that we feel that improper tax avoidance, tax evasion, usually would take the form of passive income, and I think this is well recognized. I believe we could refine the passive income proposals to a point where they would deal strictly with, first of all Canadian tax evasion, and secondly only real tax evasion; in other words, build an armslength standard into the passive income. We have recommended, for instance, that the passive income subsidiary should be judged first of all on the basis whether, if the subsidiary had not existed, any income would have accrued and be taxable in Canada or not. If this is not the case, then I do not think this Canadian tax would come into play at all.

The Chairman: Let us test that. Let us take one example of what the White Paper talks about on passive income. Let us take royalties. Suppose a Canadian company is entitled to draw royalties in respect of patents it may have in various parts of the world. In the ordinary way, how do you assess where that income from royalty payments comes? Say they are payable by concerns in England. Where would you put the situs of those royalty payments? I suppose primarily it would be the owner of the patent. If the owner of the patent is a Canadian company directly, would you call it passive income if it went to any subsidiary established anywhere else in the world?

Mr. Ellis: Yes, sir.

The Chairman: That would be passive income?

Mr. Ellis: Yes, sir. I think the key test in case of a royalty should be where the patent was developed, and which company, or subsidiary, if there is a group, paid for the development of the patent. I think this should be the key to the Canadian approach. If a patent has not been developed in Canada, then I do not think the Canadian tax laws should even try to tax the royalty income of a foreign subsidiary where a patent has been developed. I do not think Canada has the right to do this.

The Chairman: That is putting a pretty narrow area of operation on it. Let us assume a patent is developed in Canada and the first patent application is made in Canada. Then successively you have it in other countries.

Would not a logical place to establish your collection of royalties be the country where the patent rights are held? For instance, if there are patent rights in the United Kingdom as well as in the United States, and the basic one is in Canada, would you regard it as in the category of evasion, or a reprehensible thing to do, to set up a company in the United Kingdom to receive those royalty payments?

Mr. Ellis: It depends on what compensation the Canadian company receives for transferring the ownership of the patent or the patent rights.

Senator Phillips (Rigaud): Except that the original resources would have come from the parent company possibly.

Mr. Ellis: Yes.

Senator Phillips (Rigaud): Pursuant to which the subsidiary might have been able to develop the patent. Might I press the point a little further, Mr. Chairman, since we are both travelling in that direction. Do you not think the fairer solution would be that the operating subsidiaries only, inclusive of those required by municipal or domestic laws of foreign countries, should be the only ones to be regarded as legitimate offshore companies? Take, for instance, agency companies being formed and simulated as having value, and all that sort of thing. Clearly minimization or avoidance can be pretty close to evasion of Canadian tax law, and it could be that the simplest criterion from the point of view of ing of the public, and that is about the only would simply be that a control subsidiary is legitimately organized if it has to comply as an operating company under the laws of the country where it operates. I am not saying that is right, it may be too narrow, but it would certainly conform to the general feeling of the public, and that is about the only exemption that should be granted.

Mr. Ellis: If I may take you up on this, senator, I think the point we are trying to stress is that, whereas generally everybody would agree that Canadian tax avoidance, through these passive income type subsidiaries, is a reprehensible thing and should therefore be fought against, in many cases there is no reduction in any sense of any Canadian tax involved. We have put in our brief four examples of this. Perhaps a very clear-cut one is the case of a holding company, which I may perhaps quote from the newspapers in the last few weeks.

British Petroleum acquired a substantial interest in a United States oil firm. They have arranged to have this investment done through a Dutch subsidiary. The Dutch subsidiary is not an operating subsidiary in any way; it is strictly a passive income company. What they have achieved is that the United States withholding tax on dividends finally getting into the United Kingdom is only 10 per cent, whereas it would be 15 per cent if the dividends go directly. The United Kingdom revenue gains by this, because the additional profit in the reduction of tax is distributed to the ultimate United Kingdom shareholders. There are many examples like that, where through proper legal structuring of the operations the tax burden can legitimately be reduced. I agree that avoidance or evasion of tax is something that should be guarded against, but I think the legitimate reduction of tax to which the tax systems of the various companies invite the taxpayers should be open to Canadian companies as well as foreign companies.

Senator Phillips (Rigaud): As you know, the law books and the authorities are full of the grey area between tax evasion and tax avoidance.

It is our duty to come up with a suggestion as to what would be a legitimate type of off-shore operation. I, for one, cannot get beyond an operating company outside of Canada controlled by a Canadian parent company whose operation is justified as an operating company, or required by the laws of the jurisdiction in which such control subsidiary outlets. I cannot think of any other broad rule that would justify such offshore operations. When you get beyond that you are beginning to get tax minimization and not tax evasion. Nobody is suggesting that a lot of big companies and small people are evading taxes. They are doing that which the Lords and the Privy Council have said is perfectly legitimate. It reduces revenue and shifts the burden to other people. That is some of the things the White Paper is trying to eliminate.

The Chairman: Do you accept the principle that tax evasion and tax reduction are two entirely different and distinct things and that even though you may cry out against tax evasion and do whatever you can to prevent it, tax reduction has always been a legitimate enterprise. The question of course is how much grey area do you have between the two concepts.

Senator Phillips (Rigaud): I think it goes a little in respect to off-shore operations. If the off-shore operations are even legitimate from the point of view of tax minimization I think there is something to be said in favour of the principle that it should not be allowed. Somehow or another it is done out of the jurisdiction. It is an affirmative act of moving out of the jurisdiction for bringing about a legitimate tax minimization. I have a feeling that the only justification should be one where sound business sense requires it through an operating company and/or the laws of the country in which the company operates requires it.

The Chairman: Mr. Ellis, the American system, in attempting to deal with phases of this, does several things. One is that a foreign subsidiary of a United States company must bring home, or be taxed as though it had brought home, the profits earned outside. Is that right?

Mr. Ellis: For base type operations, yes.

The Chairman: Coupled with that you do have the right to apply foreign tax credits. In other words, the tax credit is recognized and it is really then the net income from outside that is brought into the American income and accounted for on the American tax base.

Mr. Ellis: That is right. It is the gross income of the foreign subsidiary which is brought into the income of the American parent and then tax credit is applied against this. One of the main reasons why the United States system has not, as everybody expected, eliminated past income subsidiary of American companies is that they are still there—and more than ever. The reason for this mainly is that they have left open in the "Subpart F" means through which the American taxpayer company minimize the impact of "Subpart F". The major exemption at this point is the so-called minimum distribution rule. If an American company brings home sufficient dividends and has paid sufficient tax, then "Subpart F" is no longer applicable. This is not applied on a per country basis but on an overall basis so that by bringing home heavily taxed dividends from foreign operations they can fulfill the minimum distribution required and therefore go free of tax in their past income subsidiaries.

Senator Phillips (Rigaud): Before I go to my last question I would like to say that you are introducing the troubles they are having in the United States, because the balance of payments question is tied in with the off-shore or foreign investments.

The Chairman: Mr. Wleugel wants to make a comment.

Mr. Wleugel: There is another important point when we talk about Canadian international companies. As Mr. Ellis mentioned, most industrialized countries do accept legitimate tax minimization through control of off-shore companies in one form or another. This is really also the approach which we are suggesting. It is very difficult for us to say what is right and wrong in moral terms other than that we can see where we have to be competitive.

I think the United States is a very typical example where they are actually opening up more and more opportunities for using tax sheltered base companies despite United States balance of payments situation. The United Kingdom permitted such companies through special legislation until the recent balance of payments crisis in 1965-66. Germany has very extensive tax incentives working actually as an incentive for investments. Although they are more strict on base companies through their tax structure they have achieved the same thing.

One important point for our company being internationally competitive is this type of arrangement to minimize taxes as part of the general international business climate. This is one point we also should be aware of when we discuss this.

Senator Phillips (Rigaud): I would like to say it is a type of international climate which is causing considerable social unrest and resentment amongst a great mass of people, and one which I feel will have to be changed. There is considerable feeling on this whole question of off-shore companies. In any event we have developed the point, gentlemen, but I do not know if we quite have the formula.

I have one last question and that is the point with respect to the excessive burden that would be placed on the middle income groupings. In view of the international nature of your operations have you any indication whether the implementation of the White Paper would have a serious bearing upon the movement of your Canadian employees outside of the country because of the excess burden of the taxation or can you express an opinion that would have such an effect if implemented?

Mr. Breyfogle: The answer is very simply yes, and it is more in the mobility backwards and forwards of people, which is the way people grow in international business. Particularly, it is to get these people to come back to Canada, with the experience they have gathered in their foreign assignment, to continue to grow the company thereafter. The people unfortunately the hardest hit by the White Paper are just the people in the middle of their career who are developing this experience necessary to guide the business in later years.

Senator Phillips (Rigaud): As to income, what is the category of taxable income, low and high, that you are speaking of in the middle income bracket?

Mr. Breyfogle: We are talking in the $20,000 to $35,000 range.

Senator Phillips (Rigaud): Would these be the people who, having received world experience or acquired world experience in the United States and other markets, who would be the ones most loath to return to Canada if there were a change as contemplated in the White Paper?

Mr. Breyfogle: Yes, sir. The tax penalty on somebody with a taxable income of, say, $30,000 is very extensive. This leaves the company two choices—either to bring him back without proper remuneration for his promotion, or to pay him a great deal of money. The individual, in looking at the latter, is sometimes tempted to think that this is a temporary situation to induce him to come back to Canada and that, in the longer term his earnings may suffer. He is located in the United States, as an example, with a proper visa and he may be tempted to leave the company and to look elsewhere.

Senator Phillips (Rigaud): Does this mean that Canadian brains would be inclined not to return to Canada and those here would be inclined to leave—all things being equal, and relating it purely to taxation?

Mr. Breyfogle: Yes.

Senator Connolly (Ottawa West): Could you give us any idea of the number of people involved in this kind of movement, within your company, within any given period of time you might choose?

Mr. Breyfogle: I am talking at a rough guess, counting up people I know who have moved in the last year, but I would say that we have at least 20 to 30 such transfers in the year, between our Canadian operating company and our parent company.

Senator Connolly (Ottawa West): These are all people with managerial know-how?

Mr. Breyfogle: Yes, and by their nature, they are most valuable people.

Senator Molson: What about recruitments? Would the effect of the White Paper have any bearing upon your ability to draw the right type of people into your company?

Mr. Breyfogle: From foreign countries?

Senator Molson: From anywhere—foreign countries, in addition to Canada or elsewhere?

Mr. Breyfogle: The managerial resource tends to be one of the highest pay-out resources. Therefore, what we would be forced to do is to pay more, reduce the shareholders' profit in order to obtain the resources we need to grow the company.

Senator Connolly (Ottawa West): When you gave us the 20 to 30 persons per year, in one year, you said "within the past year", I think, is that number a fairly reasonable number to take, for a considerable number of years past and looking into the future?

Mr. Breyfogle: I believe it would be typical of the last three years and I would hope of the next ten years, because the international experience of our people is one of their basic requirements.

Senator Connolly (Ottawa West): Because you are a multi-national company?

Mr. Breyfogle: Yes, sir.

Senator Connolly (Ottawa West): That is, perhaps, a bad way to say it.

Senator Beaubien: A man who is earning $30,000, one of that class you were talking about, how does he fare, compared to one of your executive earning the same amount here now, as the rates are now?

Mr. Breyfogle: Mr. Ellis has some numbers here, and I will just ask him to read them for you.

Mr. Ellis: For 1970, we have taken people either single, married, or married with two children. We have taken a Canadian living in Ontario, to get the provincial tax. As far as the United States is concerned, we have taken

Iowa, where we have a large operation. Also, Iowa imposes an estate tax, which is about equivalent to the average estate taxes in the United States.

On the $30,000 salary, a single man is slightly better off in Canada than he is in the United States. I should add that the assumption here is that the man has no other income than employment income; that if he is single he lives in an apartment; and if he is married he lives in an old and owner occupied house. The single man at $30,000 pays about $500 more tax in the United States than in Canada. The married man with no children pays $4,000 more in Canada than he does in the United States. The married man with two children pays, again, $4,300 more in Canada than he does in the United States, on the salary of $30,000.

Senator Beaubien: Could we have those figures attached to the brief? Those are not privileged documents?

Mr. Breyfogle: No, they are not. We would be happy to table them.

Senator Beaubien: Have you made a projection, using the scale of the White Paper?

Mr. Breyfogle: If I could add, on the first numbers, in terms of scale, we were talking about $4,000 more for the married man with two children. This is $4,000 on top of $5,800. So it is a 75 to 80 per cent increase in the tax burden.

The Chairman: Under the present Canadian tax.

Mr. Breyfogle: Under the present system. Expressed as a percentage, it is even more startling.

Senator Benidickson: Where does the $5,800 figure come from?

Mr. Breyfogle: That is the tax that would be payable in the United States. It goes from $5,800 for married man with two children, to $10,200 in Canada for the same type of person.

Senator Benidickson: Under the White Paper proposals?

Mr. Breyfogle: This is under the existing system. Mr. Ellis has some numbers here showing what would happen under the White Paper proposals.

Mr. Ellis: I also would like to make one point here, which has been mentioned several times whenever this differential was brought up. The simple reaction has been "just give him a raise in salary to compensate for the tax loss" I should add that to make up a difference of $4,000 in taxes one would have to gross it up by, I would say, at least $10,000, to make the man hold on on that basis.

Senator Beaubien: He would have to get $40,000 instead of $30,000.

Senator Kinley: Does this include municipal and state?

Mr. Breyfogle: No, sir, it does not include state income taxes.

Senator Kinley: Do you know which one is the higher, the municipal tax or the federal tax? Municipal taxes are pretty high in the United States.

Mr. Breyfogle: It is only in a few exceptions, like New York City, I believe. Detroit also has some municipal taxes. In a typical area, such as Iowa, which we feel is fairly typical, the federal is the predominant tax, with state taxes then coming along as being a rather small fraction of the federal.

The Chairman: Would you give us some other figures, Mr. Ellis?

Senator Beaubien: I think we should have all those figures in the record.

The Chairman: Yes, they will be filed.

Mr. Ellis: In the case of a married man with two children, this assumes that the 1969 United States Tax Report Act has been fully implemented and that the White Paper proposals have been fully implemented. The difference has grown to $4,600 from $4,300, so there is another $300 increase, on that basis.

The Chairman: Are the dollars that you are dealing with converted to Canadian dollars?

Mr. Ellis: No, sir. We have taken the dollar-as-a-dollar approach.

Senator Beaubien: Well then there is a difference of another 7½ per cent.

The Chairman: That is right.

Senator Beaubien: If I may ask another question, do you have any figures on somebody earning say $15,000 to $18,000?

Mr. Ellis: We have figures of $15,000 to $20,000. Under current tax rates, the difference is about $1,000 in taxes. The United States man will pay $2,000 and in Canada he will pay $3,200.

Senator Connolly (Ottawa West): Now?

Mr. Ellis: Now.

Senator Connolly (Ottawa West): Under the present law?

Mr. Ellis: Under the present law. It is about 50 per cent more. At $20,000 it goes from $3,200 in the United States to $5,400 in Canada, an increase of about 71 per cent in tax.

The Chairman: This is still dealing with the category of a married man with two children?

Mr. Ellis: Yes, this is a married man with two children. Under the White Paper, at the $15,000 level—and I should add that this is not only the White Paper, but also as a result of the effect of the United States Tax Reform Act which decreased taxes slightly—the difference is $1,300 or $1,400 almost, which is 65 per cent of the tax burden at the $20,000 level, and that is close to $2,500 which is an 80 per cent difference in tax.

Mr. Breyfogle: Expressed as a percentage, the problem has its highest incidence between $20,000 and $30,000 as the Canadian marginal tax rate climbs very steeply and that in the United States climbs more steeply.

Senator Connolly (Ottawa West): Referring back to the figures that Senator Beaubien was mentioning, at the present time there is a difference of about 20 to 25 per cent as between the taxes imposed in Canada and those imposed in the United States on a married man with two children with $18,000 to $20,000 a year.

Mr. Ellis: At $20,000 a year, the difference is 70 per cent.

Senator Connolly (Ottawa West): Under the White Paper it will be about 80 per cent. Now I do not want to seem nitty about this, but you must be having a difficult time even under the present tax laws in keeping people here or in bringing them back.

Mr. Breyfogle: Three of the members of this group have gone through this transformation, and would agree with you that there is a difficulty.

Senator Connolly (Ottawa West): They are not laughing simply because it is funny.

Mr. Breyfogle: There is a permanent little hurt down there.

Senator Molson: And all married men with two children.

Mr. R. MacLaren, Assistant to Vice-President, Public Relations, Massey-Ferguson Limited: One to four.

Senator Phillips (Rigaud): The present tax law gives quite an opportunity for one to show one's Canadian patriotism.

Senator Connolly (Ottawa West): But it is going to cost a little more yet to be patriotic. I am very interested in what you said at the beginning of your statement, and I think Senator Phillips raised the issue again. Mr. Chairman, if I may be just a little general and set the stage for the question I want to put to the witnesses. Your people have developed this business on the basis that Canada must produce and sell abroad, in other words that Canada is not only a trading nation but can be a manufacturing nation for export abroad.

The Chairman: That is an economic tenet, or should be, of any Canadian economic philosophy.

Senator Connolly (Ottawa West): I think the record should show this because my concern is that this basic philosophical principle is not recognized in the White Paper. Then it is not enough for you to establish adequate manufacturing facilities in Canada and sell competitively abroad. I take it you found you had to incorporate abroad and to manufacture to a certain extent in some countries, and perhaps selling only in others, or perhaps selling orginally leading ultimately to early manufactures and to still more sophisticated productions later. Is that the philosophy of the company, generally speaking?

Mr. Wleugel: Yes. I think when one talks about our philosophy on foreign investments abroad, meaning manufacturing investments essentially outside Canada, we probably have to differentiate between two separate groups of countries—the countries in the development world who are willing to pay a cost for the purpose of developing their own industries. This means typically Latin America countries. There we now have operating plants in Mexico, Argentina and Brazil. India is another example. The national governments of these countries accept a fairly considerable cost penalty to have us manufacture there and give them various forms of incentives which may be either tariff protection or tax incentives, financial incentives, loans, etc.

Now this series of countries, of course, is for our company a very important area in the farm machinery, industrial construction and the diesel engine areas, and our considerations for investments there are different from what they would be in the large natural markets for our products which are usually pretty well essentially in the highly industrialized countries, where you then also have subsidiary industries to justify larger scale manufacturing and where you are not pressed other than by pure economics. There may be certain incentives involved in certain regional locations here, but it is essentially one of selecting the lowest cost location for your plants and this would probably include Western Europe generally and North America as the typical area where there is fairly free plant location. And it is really one of economic analysis.

Senator Phillips (Rigaud): Such as proximity to markets?

Mr. Wleugel: Proximity to markets, the size of the market, the natural environment for sub-assembly for tractor engines.

Senator Connolly (Ottawa West): You had an earlier brief before this committee, and I forget what the subject was that we were discussing at the time. We saw the structure of your corporate organization and we were told by your spokesman that you have, I think, a plant in Malawi which produces a very primitive type of agricultural implement, whereas in India, it would be much more sophisticated, and in West Germany, even more so. Now, what I am really concerned about is this; would you say that for the purpose of holding the business that you developed in some of these foreign countries, which is not sufficient to have a good trade policy in Canada, but is necessary to establish these multi-national corporations so that you will be part of the country's economy itself.

Mr. Wleugel: Absolutely essential, I would say, and we have prided ourselves on trying to be really nationally identified in these areas.

Senator Connolly (Ottawa West): Would you go further and say that this trend must continue if Canada is to hold her position as a trading element in world trade?

Mr. Wleugel: Absolutely. I think trade is only the beginning in its simple form of export. It will be more and more in areas where you establish subsidiary companies, obtain, perhaps, component know-how interchange, etc, but basically the trend is essential for establishment.

Senator Connolly (Ottawa West): So if Canada as an industrial country is to develop as an industrial country, then this trend must continue and it must expand in other industries than your own.

Mr. Breyfogle: I think this is true, but I would not like to leave the impresssion that the pattern of trade will disappear as the pattern of investment grows. Perhaps a very simple example of that is a recent investment we made in Mexico. The Mexican Government decided they wished to have tractor manufacturing in their country, despite the fact that the country is rather small to justify a competitive tractor manufacturing process with three or more manufacturers. So we have developed a plant in Mexico manufacturing tractors.

Senator Connolly (Ottawa West): Is it profitable?

Mr. Breyfogle: It is reasonably profitable in itself, but more profitable in that by having this we are bringing business to many of our other companies around the world. For example, in Canada we are shipping combines out of our Brantford plant to Mexico. There is no indigenous combine manufacture; it is unlikely there ever will be; it is a very small country for combines. Without the tractor plant in Mexico we would not have the distribution system to sell our combines. Similarly, we are selling larger tractors out of the U.S. and we are selling large numbers of tractor components to the tractor factories for assembly purposes in Mexico. It is all part of a total pattern of trade and investment, and the more we invest the more trade comes with it, and not less.

The Chairman: And the more trade comes to Canada.

Mr. Breyfogle: Exactly.

Senator Connolly (Ottawa West): I would like to put a case to you and ask you to comment on it. The basis of it is the trading areas that are springing up in different parts of the world, with which you are very familiar, like the European Common Market. I remember one time when the Market had been established talking to an executive of, it happened to be the American parent of the Coca-Cola company, the head office. He was one of the high officials there and I asked

him, "What are you going to do when the common tariff comes in in respect of the European Economic Community?" He said, "We could not care less, so far as our American parent is concerned. We are a part of the Community because we have manufacturing establishments in one or more of the various countries of the Community." Does this also enter into the kind of thinking that the multinational corporation operating mainly out of Canada must take into account?

Mr. Breyfogle: Very definitely, yes. In our own case we have plants in Italy, France, Germany, of the Common Market countries.

Senator Connolly (Ottawa West): In other words, you are part of the Common Market?

Mr. Breyfogle: Yes.

The Chairman: I suppose, in other words, they become national in relation to whatever country they are operating in.

Senator Connolly (Ottawa West): Exactly. I think it is a rather important consideration because it is really basic to the lifeblood of this country, if we do consider foreign trade to be part of the lifeblood.

The Chairman: Yes, senator, but there is the other aspect of this which the White Paper touches on, and I wonder if you would comment. To be successful in the multinational operation you are talking about, you must be able freely to bring home the earnings. You were making some comment earlier. The White Paper proposes certain restrictions, in the way of qualifications on credit, on bringing home the earnings that you make by your operations in these other countries, and yet your operations in these other countries generate more trade in Canada for export. Is this one of the essential problems for your company that you see in the White Paper, the interference with that freedom of movement of the money from your various operations—in other words, of the foreign income to Canada? Would you care to comment on that?

Mr. Wleugel: It is not only the limitations proposed on bringing back dividends, which hurts particularly countries where Canada is not able to establish a tax treaty. These countries are typically the developing countries. Mr. Breyfogle mentioned Mexico, which is a typical example of how we operate here, with very considerable advantages from the trade and investment area. Through the White Paper proposal this comes specifically and essentially to discriminating against investment in developing countries. That is very serious for us, and we have to and are actually looking into it, very actively, in these terms.

The Chairman: It would not be an answer, would it, if in bringing that money home you were entitled to tax credit to the extent of taxes paid in these other countries, because as I understand it, you may enjoy tax incentives or low tax rates, or maybe in some places a tax holiday for a period.

Mr. Breyfogle: The Canadian Government has various programs to encourage investment, and we as a company have taken advantage of one of these—namely, our combine plant in Brantford. If we were resident in a foreign country, applying the type of approaches included in the White Paper, the tax benefit of investing in Brantford would have been totally eliminated, and as a company we would probably have done better to invest in some other country, and certainly in some other place.

The Chairman: Would you explain that? Why?

Mr. Breyfogle: Because the main advantage of Brantford was the tax holiday that was provided. We also have combine plants, for example, in England, France and Germany.

The Chairman: I am interested in this tax holiday. The Canadian Government provided you with a tax holiday? Was it on the basis of a distressed area?

Mr. Breyfogle: On the basis of a designated area.

The Chairman: So there is and has been inherent in Government policy, in other departments of Government, in order to encourage industry in regional development areas of Canada, the choice of taking a tax holiday or a capital grant?

Mr. Breyfogle: Yes.

The Chairman: It looks as though they had better get together.

Senator Connolly (Ottawa West): And the capital grant operation is continuing.

The Chairman: Yes.

Mr. Breyfogle: This is a replacement program that is in existence now, but I think it is

an interesting example that here is a program put forward by one branch of the Government which would have frustrated the effort of another branch of Government for a foreign company doing business in Canada.

Senator Connolly (Ottawa West): Would you agree though that the really serious shortcoming in the proposals on which you are making comments is the adverse effect it is going to have on foreign trade, Canada's sales abroad, more than perhaps on the development of domestic business?

Mr. Breyfogle: I think it goes a little further than this, in that almost all the White Paper seems gradually to move away from Canada being able to have companies that are international. So, to that extent, it achieves the end that you have described, of tending to take Canada out of foreign trade.

Another point on the integration is the question of the creditable tax to the shareholder. Under the system of integration a shareholder would be penalized, to a lesser or greater extent, for investing in a company with significant foreign earnings; and yet, strangely enough, the foreign shareholder in the same Canadian company would actually get a small advantage. Obviously, this changes the relative value of that share of Massey-Ferguson or another company.

Senator Connolly (Ottawa West): It is inconceivable to me, Mr. Chairman, that we should have a tax proposal that would in any way adversely affect our capacity as a nation to trade abroad. It seems to me to be inconceivable that that should happen. These gentlemen have the experience, and I suppose their experience is shared by other Canadian multinational corporations.

The Chairman: Of course, you know, the answer that has been given to that kind of statement, senator, is: "We will negotiate tax treaties."

Senator Connolly (Ottawa West): Yes, but these gentlemen say that the possibility of negotiating tax treaties is a remote and very difficult thing, and they are the people concerned because they have to sell the product.

The Chairman: How can you negotiate a tax treaty with a country that uses tax incentives and tax holidays. Why should they want to sign themselves into a kind of tax system that we are proposing in the White Paper.

Mr. Breyfogle: If you look at this matter of tax treaties in general you will see that for a country that is relatively small in international trade, as Canada is, to be totally different in its tax pattern from that of all the other developed countries would put the developing countries in the position of having to give different terms to Canada from those that they give to everybody else. It seems to me, anyway, that this puts the negotiator of the tax treaty in an impossible position.

The Chairman: I read yesterday, from the speech that the then Minister of Finance, Mr. Sharp, made in November of 1967, when he was assessing the report of the Carter Commission and indicating the difficulties that he saw in it. He announced that the Government would not adopt a radically different approach from that of the Carter Commission's report. He had this to say...

Senator Connolly (Ottawa West): This is a speech he made in the House of Commons?

The Chairman: Yes. I am reading from page 4906 of House of Commons *Debates* for Thursday, November 30, 1967. Mr. Sharp was discussing the points that had been raised in the house, and he said:

> The second point is that the commissioners have suggested for Canada a tax system quite different from that of other countries, and in particular quite different from that of the United States with whom we have an integrated capital market. This could give rise to economic difficulties, as well as to technical problems in drafting an effective law.

Mr. Ellis: I should like to make an additional point here, senator. I do not think the White Paper proposes to take Canada out of international trade. I think that the White Paper encourages Canada to engage in international trade, but as a country of subsidiaries rather than Canadian-owned companies. I do not think that Canadian-owned companies can afford to go international. I think that foreign-owned companies, as members of a foreign-based group, would keep Canada in international trade, but only on those terms.

Senator Connolly (Ottawa West): But the whole thrust of economic opinion in the country by the experts, by the people who know, is that Canada should develop on her own more multinational corporations to preserve her trading position and to increase it. Is this right, or is it not right?

Mr. Wleugel: Yes, it is absolutely right.

Mr. Breyfogle: This is very strongly our opinion too as a company.

Senator Burchill: Mr. Chairman, I should like to go back to the matter we were discussing a few minutes ago, that of the establishment of a tractor plant in a designated area, and the advantages that accrue from that. Do I understand correctly that the proposals in the White Paper would interfere with the advantages that are given by another department?

Mr. Breyfogle: No, this would only be so in the case of a company investing in a country such as Canada with tax laws such as those proposed in the White Paper in effect. In other words, it is only when this is between two countries that the investment takes place.

Mr. Ellis: I should like to make the point here that in effect the White Paper, by the integration proposal, would make the whole idea of tax exemptions or tax reductions as an economic stimulus completely impossible, because what the Government would give to the corporation it would take away from the shareholder.

The Chairman: If you do not pay you would not have a creditable tax.

Senator Burchill: That is quite a point. That should be brought out.

Senator Connolly (Ottawa West): You are bringing it out.

Senator Burchill: That to me is very vital.

The Chairman: We have touched on what I think you regard, and what we regard in an associational way, as being the critical points where the proposals in the White Paper touch on your operations, and we have developed the question of trade and the bringing in of foreign income. Are there any other items that are in that specific category?

Mr. Wleugel: To support Senator Connolly's viewpoint here very strongly, I think it appears to us that the authors of the White Paper have taken for granted that there are no Canadian-based multinational corporations, or no base for Canadian multinational corporations to develop, and they have been caught by looking upon all international corporations as, first of all, being non-Canadian owned, and then afterwards looking at certain aspects particularly in the area of tax evasion, which they have asserted in an extremely complex piece of legislation in order to get away from the disadvantages created by not encouraging the growth of multinational corporations of Canadian ownership. This is the most general commentary that we can make here as to the philosophy of the White Paper.

Mr. Ellis: On a more specific point and to bring in something that we have not touched on before, Mr. Chairman, I would say that the whole area of withholding taxes and foreign tax credit has got very inadequate consideration in the White Paper. I think that the international business of Canadian companies and Canadian individuals would be further complicated, apart from the points we have mentioned before such as integration, the exemption of dividends, and tax evasion. They would be further complicated and penalized by the withholding tax proposals and, of course, the capital gains tax proposals, unless much more and adequate consideration is given to foreign trade and foreign investment by Canadians and Canadian companies.

Senator Connolly (Ottawa West): Have you any complaint to make as to the effect upon the revenue if the present system—which, I take it, is the system you are arguing for—were continued? Would it have an adverse effect ultimately on the revenue? No doubt, the White Paper is designed to increase the tax take by government. Now, would your proposals in the long run, or in the short run, have a serious effect upon the amount of the tax take.

Mr. Ellis: Other than the integration proposal, which is, of course, a major item, I cannot really comment upon the revenue effect of our proposal to continue the existing dividend tax credit but increase it as to rate. Other than that, the modifications that we have suggested would have only a nominal revenue impact in the short run, but in the long run they would have a very beneficial revenue impact by providing a stimulus to Canadian trade and international investment. Of course, this is a point. For example, the proposals in the White Paper labelled together under the heading Provisions Directed Specifically Against Tax-saving Abuses show a revenue effect in the first year as well as the fifth year of about $10 million. I wonder if this figure is negated by the administrative cost? If we have the administration cost of these figures both on the taxpayers and the Government side, this figure would probably be negative.

Senator Connolly (Ottawa West): Surely if we are going to argue, as I and, I think, you

do, that the encouragement of the Canadian-owned or based multinational corporation is a desirable thing for Canada, in the long run if business does develop and the company grows the Canadian treasury is going to benefit, because you will be repatriating profits you obtain abroad to add to those at home.

Mr. Breyfogle: And we will be paying dividends to our Canadian shareholders.

Mr. Wleugel: In the last five years we have repatriated dividends of about $70 million, of which Canadian shareholders received about $43 million.

During the last five years we have had exports of approximately $500 million from Canadian operations alone.

The Chairman: Would that be measured in terms of U.S. dollars?

Mr. Wleugel: No, this would be Canadian dollars.

The Chairman: But your trade abroad produces U.S. dollars?

Mr. Wleugel: Yes.

The Chairman: So it advances—cause of balance of payments.

Mr. Wleugel: Absolutely and totally.

The Chairman: Have you any percentage as to your contribution to the balance of payments?

We have been told by the extractive industries that they provide about 30 per cent of the foreign exchange in Canada.

Mr. Breyfogle: We have not calculated it in those terms. To repeat the numbers I mentioned briefly earlier, it is perhaps relevant that of the sales in the Canadian operating subsidiary last year of $171 million, $73 million were domestic sales and $98 million export.

Senator Connolly (Ottawa West): Just of the Canadian operation?

Mr. Breyfogle: Yes.

Senator Connolly (Ottawa West): This is not your subsidiary manufacturing operations abroad?

Mr. Breyfogle: No, this is just what we are doing for the Canadian balance of payments relatively speaking, while over half of our production in Canada is going abroad.

Senator Phillips (Rigaud): You would get a greater balance of payments as you repatriate dividends.

Mr. Breyfogle: Yes.

The Chairman: Mr. Ellis, when you were referring to the tables in the White Paper as to what tax revenue could be in certain directions if certain proposals in the White Paper were implemented, I believe it was indicated that integration, according to the calculations in the White Paper, produces or is estimated to produce a minus as far as tax revenue is concerned.

Mr. Ellis: Yes.

The Chairman: So it cannot be urged on the basis that the Government needs more money.

Mr. Ellis: The link is very obvious when the numbers are considered. The real purpose of the integration proposal, as we say in our brief, is to provide an increased incentive to Canadians to invest in Canadian companies. This is necessary because of the capital gains tax.

The Chairman: Yes, but supposing you carry on with that, how can you assume that that is the purpose of the White Paper? The individual tax rates are designed in such a way that at the end of five years it would produce increased taxes over what are realized now of about $650 million.

It was acknowledge to us by Mr. Bryce and Mr. Brown that that would come out of the savings of this middle income group to which we are referring and the increased rates of tax that are being imposed. Therefore you are depriving this group of the ability to save, to the extent of $650 million.

It is hard to draw that conclusion, Mr. Ellis, that this is the design, although I agree the White Paper does so suggest.

Mr. Ellis: If the existing dividend tax credit is to be retained in its present form, we say that it would be necessary to retain this balance on the equity investment for Canadian investors.

I have not been able to judge the revenue effect of how much the dividend tax rate should be increased to provide this counter incentive. However, when I answered the question earlier I said, apart from this, one the modifications that we are proposing probably would not even show up in the revenue

estimates, because they are too small to be worried about.

Senator Desruisseaux: You made reference to the inflationary effects of the White Paper and the added attraction of dividends through integration and the two and one-half year proposed time limit on corporation distributions. You also made a point with reference to the upgrading of certain areas of salaries.

In view of that, would the inflationary effects be of such magnitude as to change your competitive position in world markets?

Mr. Ellis: I admit total incompetence on this point. I do not have the research, nor the means available, to even try to carry it out in order to arrive at an estimate of exactly what the inflationary effects of integration and upgrading of salaries would be. I am sorry, I cannot answer your question.

Senator Desruisseaux: But that would not be good for you.

Mr. Wleugel: That would not be good, no.

Senator Phillips (Rigaud): I am not clear on one point. It was stated that the White Paper, if implemented, would obviously be troublesome to a Canadian investor but would improve the status of a non-resident shareholder. Could you explain that for me?

Mr. Ellis: Certainly; if we make an assumption and take our own example, a Canadian company with a very significant amount of foreign earnings. Under the White Paper proposals the Canadian investor in such a company...

Senator Phillips (Rigaud): He is in trouble, I know that.

Mr. Ellis: ...would lose his dividend tax credit, or part of it. He would be worse off than had he invested in a purely Canadian company. Now, the foreign investor at the moment gets his dividend on which is levied in our case a 10 per cent withholding tax. However, under the proposals of the White Paper this foreign shareholder would credit against his Canadian withholding tax, against this 10 per cent, the foreign withholding tax paid by the Canadian company when it received the dividends from its overseas subsidiaries. For example, if we had no other earnings in a year than the difference, say, from the United Kingdom on which a 15 per cent dividend tax is levied, the U.K. shareholder getting his dividend out of this income would not pay any withholding tax and would be better off by getting the benefit of the 15 per cent paid by the Canadian corporation which would flow through as an offset against his own withholding tax. He would be better off in that regard than he is now.

Senator Phillips (Rigaud): Thank you.

The Chairman: I put a question to you awhile ago as to whether there were any other features that are of a critical nature when we look at the White Paper in relation to your operation. We have developed a number of them.

Mr. Ellis: Yes.

The Chairman: Are there any others that we have not developed in the discussion?

Mr. Ellis: I would like to mention here the capital gains on foreign assets and foreign investments. Without getting into the philosophy of capital gains itself, I think that it is essential for all companies engaged in international trade that the same roll-overs, the same exemptions, that would qualify for a domestic capital gain should apply to a foreign capital gain as well. I am talking particularly in terms of reorganizations. In the international business environment it is sometimes necessary and essential to reorganize your business on very short notice. Under the White Paper proposals this would probably result in a taxable capital gain without a roll-over, even though the underlying ownership of the asset has not changed at all. And I would say that this is an area that is of great importance to Canadian companies in international business.

The Chairman: If you don't feel you should comment or are not prepared to, you can say so, but, if instead of looking on capital gains in the integration and grossing-up picture you looked on capital gains as being just what it is called, capital gains and not income, and you had a separate tax, what would be your comment? For example, they do have a separate tax in the United States. I am not suggesting a Canadian capital gains tax should be the same amount as that in the States or a lesser amount, although such suggestions have been made to us, but I am suggesting that there would be some limiting features on it. The way in which the stock market has been behaving these days, if the capital gains tax as proposed in the White Paper were in effect you might run into such tremendous amounts of losses that the earned income available on which to levy income tax might shrink very

considerably by the deduction of capital losses.

Mr. Ellis: I really don't want to comment on the capital gains tax as such and the rates and the system.

The Chairman: But should it be a separate tax rather than being construed as income?

Mr. Ellis: I think so. Very definitely.

The Chairman: A separate tax.

Mr. Ellis: But on the point you made about losses, it is very interesting that the United States went the reverse way on capital gains, of course.

The Chairman: That is right, yes.

Mr. Ellis: The capital gains and capital losses were originally part of income and losses could offset earned income. Then the depression came along and they changed the law in a hurry.

The Chairman: Is there anything more you would like to add?

Mr. Breyfogle: If I could just make one more point which I think summarizes this question of a multinational corporation and the need for it in Canada, I would come back somewhat to the passive income discussions we started off with, Mr. Chairman. The multinational corporation can only grow in Canada if the tax exposure that it has does not penalize it by comparison to the tax exposure of a company domiciled in another country. I think that that, while looking at the very complex aspect of passive income, is something that must be kept under consideration. As proposed by the White Paper, even with some modifications, the passive income proposals would still penalize a Canadian multinational company to a significant extent.

The Chairman: By reason of what?

Mr. Breyfogle: By reason of the fact that a company located in, say, the United States, England or Germany, for example, would have significant tax advantages over a company located in Canada because of the foreign located company's ability to use legitimate tax limiting activities. Perhaps it might also be significant to note that in looking at the farm equipment business in Canada over the last 20 to 30 years it is hard, for me at least, to see that Massey-Ferguson could have survived if it had been solely a Canadian company without substantial multinational investments and trade opportunities. The problems of the mid-fifties alone, I think, would give credence to that statement.

Senator Connolly (Ottawa West): Would you agree that the thrust of the White Paper in this respect is almost to create a nationalistic atmosphere in respect of Canadian industry and almost to restrict the growth of Canadian industry to the growth of the Canadian economy regardless of foreign trade?

Mr. Breyfogle: Yes, sir, and I believe that the penalty for such nationalism will be even greater than is foreseen by many economists today.

Senator Connolly (Ottawa West): On the Canadian economy.

Mr. Breyfogle: On the Canadian economy, yes.

The Chairman: Even when you say that, you then look at another phase of the White Paper, the Canadian shareholder vis-à-vis the foreign shareholder in relation to many operations in Canada, and you see that the foreign shareholder is at an advantage. How can you then say that the main thrust of the White Paper is in the direction of nationalism?

Senator Connolly (Ottawa West): In that respect you are quite right. In another respect, though, the main trust is toward nationalism.

The Chairman: Yes, that is right. So it is a mixture.

Senator Connolly (Ottawa West): That is right. You get the worst of both worlds.

The Chairman: Sometimes it is an effort to do that, but apparently it can be done.

Senator Carter: Mr. Chairman, in the presentation that we have before us I wonder whether the comparisons with the White Paper have been worked out on the basis of the first year of the proposals or the fifth year of the proposals, at which time there would be a considerable lowering of the corporate tax rate.

Mr. Ellis: I am not quite aware of which comparison you are referring to, senator.

Senator Carter: Well, after four years the tax comes down to 50 per cent, doesn't it?

Mr. Breyfogle: On the personal income tax, sir.

Senator Carter: And the corporate tax.

Mr. Breyfogle: While the personal income tax comes down to 50 per cent, it still plateaus at a 50 per cent level. It is very low. It is somewhere around $24,000 taxable income. So that it hits right into these key people we are talking about—the middle management people, and, in fact, the relief comes only in the higher income levels.

The Chairman: We were concerned with certain figures, and in fact discussed the areas from $30,000 to $35,000 and from $15,000 to $20,000 for individuals, and we made comparisons as between Canada and the United States for the present time and such a time when the White Paper rates become effective.

Mr. Breyfogle: When they become fully effective this key middle management man will be paying 80 to 82 per cent more tax in Canada than he would in the United States.

Senator Molson: That is after five years.

Mr. Breyfogle: That is after five years when fully effective. However, at over $100,000, for example, it goes down to 35 or 26 per cent, and then at $150,000 only 20 per cent more tax. This is where you see that 50 per cent ceiling cutting into a person with high earned income.

The Chairman: That concludes our consideration of this brief. Thank you very much.

Mr. Breyfogle: Thank you very much, Mr. Chairman, and we appreciate this opportunity.

The Chairman: The next brief we have is from the Canadian Federation of Agriculture. We have here Mr. Munro, the President, and Mr. Kirk, the Executive President. They have with them Mr. Davidson, an Executive member of the Ontario Federation of Agriculture.

Mr. Munro, will you proceed?

Mr. C. Munro (President, Canadian Federation of Agriculture): Mr. Chairman and honourable senators, I am assuming you have read the brief we are presenting and that it will not be necessary to go through the text of it by reading it at this time.

The Chairman: That is a reasonable assumption, Mr. Munro.

Mr. Munro: However, at the conclusion of the brief we set out a summary of major recommendations, which I think we can take a look at, take them one by one and go down the list.

This is our summary of major recommendations:

1. Substantial reduction of estate taxes and succession duties.

2. Assurance of continuous family ownership of the farm without realization of capital gains until sold outside the family.

3. Adjustment of capital gains downward to take account of inflation, or, failing this, abandonment of the taxation of longer term capital gains on land.

4. Provision for investment of capital gains in registered retirement funds, tax exempt, except as received in retirement income.

5. Flexible opportunity for farm adjustment through sale of some assets and re-investment in others, without capital gains realization.

6. Adequate provision for averaging back of capital gains.

7. Initial value for calculation of capital gains at not less than cost to the farmer. Adjustment for depressed land values at valuation day, where they occur as a result of farming conditions.

8. On inheritance, addition to initial valuation of all estate taxes, succession duties, and legal costs of the transfer of the estate.

9. Recognition of separate principle residence for each farm operator in family joint operations, partnerships, corporations or co-operatives.

10. Retention of 5-year averaging provision.

11. Retention of the basic herd system.

12. A standard maximum rate of depreciation on depreciable farm assets of 20 per cent sstraight line and 40 per cent diminishing balance.

13. Recognition of earnings of wives from work for the farm as expenses of farmer.

14. Acceptance of government burden of proof in case of disputed valuations, and payment of $\frac{3}{4}$ of cost of independent valuation by farmer, when this is required for his protection.

15. Early publication of detailed information on valuation procedures and rules, and proposed regulatory and valuation procedures.

16. Allowance of training costs as an expense of doing business.

17. Careful Federal-Provincial examination of overall tax system to ensure equity of

treatment, and relief from burden of education costs on real property taxes.

That is the summary of the points we have in our brief. We have just received a report from the Task Force on Agriculture, which has a heavy economic as well as social thrust. It mentions nothing about what the tax system can do to us as Canadian farmers. We are concerned, and this is a summary of our concerns. We are very anxious that the Canadian business family farm system can be retained in Canada, because certainly the Canadian consumer has benefitted in a major way in comparison with other countries of the world.

That is a summary of our position right off the cuff.

The Chairman: Mr. Munro, if you are putting your finger on a place to start, which item would you put your finger on first?

Mr. Munro: I think we are vitally concerned with the inflation prospects if the capital gains concept is accepted. It is our opinion that we should have some means of having an inflation factor, because we could get into just plain confiscation of resources if we do not have some factor to take care of this. I think Mr. Davidson would be prepared to deal further with this area. He has worked on this very extensively from the Ontario source for our organization.

Mr. Malcolm Davidson, Director, Canadian Federation of Agriculture; and Executive Member, Ontario Federation of Agriculture: Mr. Chairman, we think it should be recognized that if inflation continues at its present rate, in 20 years the face value of a farm may double; the real value will stay exactly where it is.

Senator Aseltine: Right now the value of farm land is down to nothing in western Canada.

Mr. Davidson: If year by year the face value goes up and inflation remains, or if there is no real increase in worth, then when you sell the farm you cannot buy any more goods and services. If there is a tax on that apparent gain it constitutes straight confiscation. In our opinion a tax system which confiscates wealth would be unacceptable. To tax capital gains, if they are really capital gains, will allow the seller of the capital to buy more goods and services. A tax on real capital gains is acceptable.

The Chairman: You are talking about a capital gain from the sale of a farm?

Mr. Davidson: Yes, a farmer who has a farm for 20 years and sells it.

The Chairman: Inflation is not selective.

Mr. Davidson: For farmers.

The Chairman: It is not selective in its effect on various objects. If the price of farms becomes inflated everything else becomes inflated at approximately the same rate.

Mr. Davidson: This is precisely my point. The point is that when a farmer sells his farm what counts is not the effect on the farm but the effect on the farmer's ability to buy goods and services with the money he receives for his farm. His ability to buy goods and services is reduced by inflation. It is when he disposes of assets that he must pay a capital gains tax. He then has a problem as to what he can buy with that capital. If he is taxed on the difference, which may be purely imaginary, he in fact is losing money.

The Chairman: Perhaps the proper approach—and we discussed this before when we had the apple growers here from Annapolis Valley, Nova Scotia—would be that so long as farms are passing from hand to hand and being sold, and so long as the use of the farm is not changed in the process, there should not be a capital gains tax applicable. It should only be applicable when the farm is sold for other than farm purposes, such as land development and industrial use. As long as it retains the character of a farm there should be no capital gains.

Mr. Davidson: We could probably support that. The problem is that the change of use only adds very slightly to the vlue, and you suddenly put that person into a capital gains bracket which he was not in the day before. It may be a problem of definition, but I think we can certainly consider that, even though we have not given it any specific thought.

The Chairman: It might well be a step in the right direction.

Mr. Davidson: Certainly it would be an improvement over a situation which confiscates value.

Senator Phillips (Rigaud): I do not think we are going to get very far in this presentation if we deal with the subject matter of inflation. The whole problem of inflation in relation to capital gains is too nebulous and

uncrystallized. It may justify a special rate for capital gains as distinguished from rates of taxation applicable to income.

I am assuming in this brief that you are not proposing that the application of the inflation problem be related only to capital gains involving the sale of farms and homesteads, but you are relating it to the whole question of capital gains.

Mr. Davidson: Yes.

Senator Phillips (Rigaud): I think we will make more progress, because of your right to make progress and because of the importance of the farming element to the economy of the country, if we confine ourselves to that problem as distinguished from estate taxes, retention, five-year averaging provision, etc., for which I do not think we will find room for conclusions dealing with the subject matter of the White Paper.

I would like to direct myself more particularly to paragraph 2 which is one that our chairman touched on. I have already expressed the view that it is the responsibility of Canada to see that those who have been engaged in farming throughout the years, and who have looked after the sustenance of the country, are entitled to unique consideration. We give subsidies for manufacturers in distressed areas and export trade, and I think we should recognize the fact that there is no such thing as a real market for a homestead or for a farm that is being used for farming. I have indicated bofre that you cannot compare the ownership of a farm and a home associated with a farm with the ownership of a share of a listed stock or a share in a commercial corporation. I for one would strongly support a finding by this committee that if capital gains were introduced in this country we should have a very simple rule affecting farmers with respect to capital gains. If a farm retains its identity as a farm, and I do not mean that one part is used for a park or a road by the municipality, but if the essential character of that piece of land and the homestead is retained in the productive process of that country to be turned over to an orchard or for something else as distinguished from wheat, that the capital gains tax would not apply. If we did that we would be rendering a legitimate service to the *bona fide* farm community of this country which had the guts and fortitude to open up our country. In respect to those who did not open up the country, they would have the guts to carry on and engage in the process of producing the nutrition that Canadians need.

How serious would it be if we said that as long as the productive capacity and character of the farm was retained, and the ownership was only changed between a son, daughter, son-in-law or cousin, that no capital gains would apply?

The Chairman: Senator Phillips, I know your views and you expressed them the other day. I think item 5 of the summary ties in with what you have been speaking about under item (2) We had this question the other day about selling off portions of a farm. What you are saying is that if the main body of the farm remains the essential character of a farm that no capital gains tax should apply.

Mr. D. Kirk, Executive Secretary, Canadian Federation of Agriculture: We have been just as concerned as you about where we are going with this inflation factor. We think it is an extremely valid point in its fundamental application. On page 4, in paragraph 11, we say:

> Perhaps indeed to abandon taxation of longer term capital gains on farm property would be the best way of dealing with the problem.

I think it was the same kind of considerations, and concern you have in mind, that led us to put that in. We had a little hesitation, in general, about basing our whole brief on the simple proposition of a special case.

Senator Phillips (Rigaud): Mr. Chairman, I had overlooked that and therefore I have no right any more to claim paternity for the suggestion. It is here, and I would like you to read that paragraph of your brief into the record, this particular paragraph of your brief. Would you be good enough to do so?

Mr. Kirk: The paragraph reads:

> Unless this problem of the inflation factor in capital gains is recognized, and methods developed to deal with it, the federation will be forced to oppose introduction of a capital gains tax in any form on farm property. Perhaps indeed to abandon taxation of longer term capital gains on farm property would be the best way of dealing with the problem.

Senator Phillips (Rigaud): With the consent of the chairman, would you be good enough to refer to your summary, which we have just heard read, I think by Mr. Munro, and in the summary of major recommendations, would you be good enough to read recommendations 2 and 5? Then I think we will have the picture before us.

Mr. Munro: Recommendations Nos. 2 and 5 read:

> 2. Assurance of continuous family ownership of the farm without realization of capital gains until sold outside the family.
>
> 5. Flexible opportunity for farm adjustment through sale of some assets and re-investment in others, without capital gains realization.

The Chairman: Senator Phillips, in that connection, I think that recommendation 2, which Mr. Munro has just read, is too restrictive.

Senator Phillips (Rigaud): Yes, I thought so.

The Chairman: That is limiting only to a sale among members of the family. That is not our concept as we have expressed it here. Our concept is that, as long as the essential character of the farm operation is retained, then capital gains should not apply to any succession of sales.

Mr. Kirk: Yes, that is the concept that is expressed.

The Chairman: And I understand that you would subscribe to that concept?

Mr. Kirk: Yes.

The Chairman: Senator Phillips, it may be we have inferentially dealt with item 3, where they talk about inflation, because to the extent that the capital gains tax does not apply they are not concerned with that problem in connection with the sale price of the land.

Senator Phillips (Rigaud): Yes, but with the observations we have made and have read into the record, we have got our views crystallized. I am a bit redundant, but my feeling is, on this whole problem of inflation in relation to the value of money, you can argue that you are paying with an inflated dollar and all that sort of thing and in any event you are fighting battles you should not be fighting, that industry at large, commerce and finance should be fighting, the battle of capital gains. I think the real issue with you gentlemen is that you have a commodity that is not a marketable commodity. There is no such thing as a buyer and a seller in a free market and there are certain factors inherent in the nature of the service that you render to the country, and for that reason I am taking the position that you are justified in segregating yourselves from the application of a particular tax.

Mr. Davidson: I think the problem we faced, when we prepared this, is that one has to decide, if one goes for that approach and is successful, fine; if you go to that approach and deal with none of the problems, if that approach fails, it may be you have lost a lot of other items that should have been mentioned. So, in a sense, we thought that we had no choice but to discuss these other things, and make sure that we had on the record our views on all of the points.

The Chairman: It is quite simple to deal with that. All you are saying is: "Now, here is the principle we think should apply, no capital gains on farms, under certain circumstances, in the sale of the farms; but, in the alternative, if we have to discuss the proposals in the White Paper, then this is what we have to say about them."

Mr. Davidson: Essentially, that is it.

The Chairman: That is your case?

Mr. Davidson: Yes.

Senator Aseltine: Mr. Chairman, that is exactly what the farmers in western Canada are worried about right now. There is practically no sale at all for grain. We are cutting down our wheat acreage. The value of the farms have gone down from the peak to practically nothing. You cannot give a farm away, almost, in the district where I come from, the Rosetown Plains which are famous for their wheatgrowing. But we are quite certain that that condition will not prevail indefinitely.

The Chairman: Senator Aseltine, you have a lot of company at the present time. Have you looked recently at the stock market reports from day to day?

Senator Aseltine: Yes, I looked them over last night. The situation that the farmer is in is that, when times get better on this land, which will be valued at valuation day very low, we do not know how it will be valued at all when it comes back up. Then, when the farmer wishes to retire, to turn the farm over to a son or neighbour, he is going to have a great capital gains tax to pay and he will be on welfare and relief, when he retires and gives it up. So this is a very vital point for the western farmer.

The Chairman: We will do the best we can.

Mr. Davidson: I would like to say that on page 6, in section 6.17 we deal with this problem, keeping the western farmer particularly in mind, where we discussed the problem of depressed capital prices at valuation day, which may go up and give an imagined capital gains which is not real. We suggested that this must be taken into account, in the case of the western farmer.

The Chairman: Mr. Davidson, we will watch, in anything we do or say, to see that the alternative positions are presented.

Senator Molson: For the record, might I ask Mr. Munro to give a short description of the membership and composition of the Canadian Federation of Agriculture?

Mr. Munro: Mr. Chairman, we do have a member organization in each province with the exception of Newfoundland, where agriculture, as you know, is at a minimum. These many instances do take direct membership organizations within the provinces, they do have many commodity boards and major organizations of commodities, of farmer associations, in membership as well, in the specific provinces. We do have in direct membership as well the Dairy Farmers of Canada, the United Grain Growers and the Canadian Horticultural Council. So our membership really almost completely embraces the Canadian farming sector.

Senator Molson: Would you suggest a figure for the overall membership that are involved through the member associations, with your organization?

Mr. Munro: I will let our executive secretary, Mr. Kirk, answer that question.

Mr. Kirk: Well, it is in the nature of our organization that you cannot count heads. It is an overlapping structure organization—a federation. But I think there is no doubt that at least 90 per cent of the farmers are affiliated through their organization with the Federation.

Senator Aseltine: The United Farmers?

Mr. Kirk: The only significant farmers organization that is not in the Federation and not affiliated to the Federation really, organized manifestations of farmer action in any field, is the National Farmers Union, and of course many of their members are in fact affiliated to our organization through other channels and are active in it.

Senator Phillips (Rigaud): But you have answered Senator Molson's question that 90 per cent across the board of those engaged in farming across the country would be represented in some form in your organization.

Mr. Kirk: That is right.

Senator Haig: Mr. Chairman, in the brief at page 11, section 32, you refer to the question of training costs as expense and the need for many farmers to avail themselves of short courses and other forms of training while continuing the operation of the farm. Would these be at the university level?

Mr. Munro: In many instances it could be, but in other instances it is not necessarily so. For example, we are hoping now that we have the task force paper on agriculture, that there will be seminars held in various provinces which will mean an out-of-pocket expense account for the farmers participating, and this may be a complete orientation through the farm organization.

Senator Haig: In your question here you mention the fact that there is attendance at business meetings of your organization. Are these by delegated votes of affiliated organizations or can any member go there?

Mr. Munro: It is completely by delegate at our annual convention. We could not operate on any other basis within Canada in view of the geography, and so these are representative people of the various organizations from the provinces.

Senator Haig: Am I correct, Mr. Munro, in suggesting that you are approving of business expense the same as conventions for other professions like lawyers, doctors and dentists?

Mr. Munro: Well, I suppose, in major aspects, yes. But there will be some difference because initially our people attending are much more stringent in the amount of money they have available to participate.

Senator Haig: We are allowed two conventions a year. We attend them and then we submit our expenses and deduct that from our income tax. Is that your intention under paragraph 32 and 33?

Mr. Munro: Perhaps Mr. Kirk would care to give more detail on this.

Mr. Kirk: I think really, sir, we had not really given our attention to this in terms of business expense. What we were concerned with was that the amount of money expend-

ed, perhaps in the form of payments from the organization as an expense to delegates—what we were concerned about was that those expenses would not be considered as income to the farmer going there on farmers' legitimate business.

Senator Haig: Does the Federation pay the delegates to come?

Mr. Kirk: The organization very often pays the representatives because the farmers could not afford to represent other farmers at meetings throughout the year and pay their expenses back and forth throughout the country.

Mr. Davidson: We are concerned that in the White Paper it is reflected that all convention business expenses would be subject to the discretion of the Minister.

Senator Haig: It is now.

Mr. Davidson: But there is no indication to us of how or when this would be permitted to use legitimate business expenses or what would be considered legitimate. I think this is what we are concerned about.

Senator Haig: We have had this discussion with other professional groups in the same way. But you are reversing the situation. You don't want these expenses to be taken as income.

Mr. Kirk: Our main concern is that they should not be added to income.

Senator Molson: Mr. Chairman, might I ask Mr. Munro if he has any views on the elimination of the lower rate of taxation on small businesses?

Mr. Munro: Mr. Chairman, I think this is a concern. We are moving into the area of attempting to retain the family character in many instances of small farm corporations, and I think this is a vital concern to us. I know it would be to me, if I can use a personal example, because now I have a son who is in the business and we have become recently incorporated in order to give proper transfer opportunities and stability to the business. I think this will be an increasing concern to farmers because as the amount of money that is involved within a business and the amount of technological equipment that must be acquired in order to have a satisfactory operation—we are going to see more and more farmers move into small incorporated businesses, and I think the 50 per cent level of taxation right across the board does concern us.

Senator Molson: If I understand you properly, you would say that the form of advantage given to small business that presently exists in having a rate of 21 per cent of taxation on the first $35,000 might be retained or something similar might be retained?

Mr. Munro: Yes, this is my point exactly. I realize the concern of those who have been in a position to juggle the tax laws in setting up a number of small corporations in order to stay within the lower tax bracket. I realize it is a concern, but surely there can be ways and means devised to deal with this.

Senator Benidickson: The Minister now has a discretion.

The Chairman: It has been remedied by amendment.

Mr. Munro: You are away ahead of me on that.

Senator Benidickson: There is a lot of talk about it, but the income tax people have a discretion to say "these are affiliated companies and the lower rate shall apply only in one instance".

Mr. Munro: But certainly on acquiring the tools of technology that are becoming increasingly available to us, and if we must remain competitive, which we must, in world markets, then we have to have a means of retaining capital in the business, and this is a definite concern to farmers—the higher tax bracket on small corporations.

Senator Molson: One way, then, of remaining competitive and keeping up to date in the modern trend will probably be, as you suggest, more incorporation of farm operations.

Mr. Munro: I think this goes without saying because I know this is happening in various areas in Canada. There is increasing interest shown in this in order to give the proper transfer from father to son or to son-in-law, or whatever it may be, a cousin or a nephew coming into the business, and I think this is a transition we are going to see accelerating within the Canadian economy.

Senator Carter: Do you have any figures on the numbers of farms incorporating now? Do you have any percentages?

Mr. Munro: I do not know whether Mr. Kirk has any figures on that or not. I certainly have not. I don't know.

Mr. Davidson: I understand it is about 5 per cent. But that is 5 per cent of a very large number of organizations that are called farms. Of course if one tries to define a farm, one gets into trouble right away, so it is a question of being 5 per cent of what.

The Chairman: Even without the necessity for incorporating, as a matter of law, you could apply the 21 per cent to a small unincorporated business by stipulating if it is a partnership this is the rate.

Mr. Munro: I am sure this kind of flexibility must be incorporated, Mr. Chairman, because again as we take a look at it, we have to take a look at whether we form an official partnership or whether we go through the incorporation laws, and this is the challenge that is facing farmers consistently.

Senator Carter: The reason I ask that, Mr. Chairman, is because one of the recommendations is that the wife who works on the farm should be paid and should be treated as an operating expense. You would have to be operating as a business. Under what circumstances would you not do that?

The Chairman: Farming is a business, is it not?

Senator Carter: Yes.

Mr. Kirk: If I understand it correctly, if a farm is not incorporated you cannot pay wages to the wife and claim that as an expense. That is considered as a less than arm's-length operation and too subject to abuse to allow. This is the tax people's view.

Our point is quite simply that this is not a good enough reason for what we consider a clear discrimination, because farm wives do in fact work and contribute, and we are asking that where they are paid in relationship to the work they do—which is a problem in many small incorporated businesses and it is dealt with—it should be dealt with in the absence of a corporation.

The Chairman: Of course, Mr. Kirk, you know you have to be very careful as to the amount that is paid, because I take it that the husband will not want to find himself in the status of a single person for income tax purposes. You have to weight the benefits and the lack of benefits in doing that sort of thing.

Mr. Kirk: That would be the farmer's business.

Mr. Munro: But again, Mr. Chairman, I am sure that other people in our economy do likewise, where the wife takes a job and her husband is also working, and that same consideration arises as to whether she takes a job or not.

The Chairman: Yes. We have had representatives from Simpsons-Sears, Eaton's and others on the category of the part-time employee, the wife who works for a certain period of time—which is necessary in the business world today—so we are aware of the problem.

I was wondering if you would care to say something about the retention of the basic herd system. Can you tell us briefly how that works now, and how the proposals in the White Paper will hurt you?

Mr. Munro: I am going to let Mr. Kirk answer that question, Mr. Chairman.

Mr. Kirk: Well, I am not a detailed expert on the question of basic herd administration, unfortunately, but my understanding is that basically what happens is that the farmer applies to have a certain portion of his livestock recognized as initial capital. Therefore, following that initial decision, from year to year he has the option of adding to that herd and having the value of the animal recognized as an addition to capital, and similarly it has to go into income in that year. If you add to that capital amount, that also has to be recognized on the income side, and he may build up his capital on this basis. The characteristic of the basic herd is that it is calculated in terms of animal units and not in terms of money.

Senator Benidickson: Do you see something in the White Paper that is a threat to the present practice of taxation with respect to the basic herd system?

Mr. Kirk: Yes, the White Paper recommends its termination. They say that on the coming into force of the act existing basic herds will be valued at their value at that time and recognized as capital, but that will then be the end of the basic herd system.

We think it is a useful mechanism for farm planning. For many farmers this is a very useful and orderly way, when they are not on an accrual basis, knowing their position and building up their herd capital, and we do not think that the potential increase in the money value of those cattle, because it is on a unit calculation basis and not a money basis, is going to be significant enough to be a matter of concern.

The Chairman: That is developed in the brief on page 8, paragraph 23.

Senator Burchill: Under the White Paper, if the basic herd business is eliminated and in future a man wanted to add to his herd, that would be a charge against operating, would it not? I mean, the cost of the animals that he would add to his herd, it could not be charged to capital but to operating?

Mr. Munro: It becomes income for the year, and you have to take the average of your sales, if you have had sales, and it is added to income, if you wish to increase your basic herd.

Senator Burchill: If he wants to add to his herd.

Mr. Kirk: It depends whether he is on a cash or accrual basis. If he is on a cash basis and is not running an accrual system on his assets, then the way it would work after that would be, if he bought an animal and added to his herd, he would have an added expense and this would correspondingly reduce his income.

Senator Carter: I am not a farmer and know nothing about this, but how do you assess the value of a herd? Would the assessment or the valuation of the herd be affected by fluctuations in the retail price of meat?

Mr. Kirk: Do you mean of the basic herd?

Senator Carter: Yes.

Mr. Kirk: No, the basic herd has nothing to do with this. It is not calculated on value, but on the number of animal units, and a young animal is a fraction of a full unit. It is based on purely physical terms; that is the point.

Senator Carter: If you take out your basic herd, on your remaining animals would the same principle hold?

Mr. Kirk: It would be on a money basis then, but a question of how much you got for them on actual sale or how much you paid for animals you acquired.

Senator Carter: And that would be affected by fluctuations in the price of meat?

Mr. Kirk: Yes.

Senator Kinley: But there would be no capital gains?

Mr. Kirk: No, there would be no capital gains. All sales, as they are now except for the basic herd, would be considered as income, and the disposal of the herd presents a real income problem, which is another matter we mention.

The Chairman: Mr. Munro, are there any other items here in your summary that we should direct more attention to?

Mr. Munro: I think the next item may be the retirement fund concept. I think Mr. Davidson might like to deal with that.

Mr. Davidson: Mr. Chairman, there are two or three points. By the very nature of the occupation and the way in which the technology changes, farmers tend to put every spare dollar they have back into the farm, either to pay off the mortgage or to buy more land or capital equipment. They do not, therefore, have spare cash with which to buy a retirement fund.

What we are suggesting is that they be given the opportunity, when they sell their capital, to take part of that capital gain, before it is taxed, and place it as a lump sum to buy an annuity, and this payment or annuity would be taxed in the normal way anybody else's retirement fund is taxed; but that would be an allowance before the capital gain was taxed. We think that this is very desirable from everybody's point of view, but that it would also be justice to the farmer who has in fact been reinvesting in the farm and has really considered that to be his retirement fund. If he has a lump sum capital gain of perhaps 50 per cent he will be penalized compared with what he might have had if he had put it in another retirement fund.

The Chairman: Mr. Davidson, this is on the assumption that we recommend that there be a capital gains tax on farms.

Mr. Davidson: Yes, and this is, of course, the problem. We are back again to the fact that if there is no capital gains tax on land then much of what we have said becomes irrelevant.

The Chairman: Also, if we recommend, and it ultimately becomes law, that a farming operation up to a certain amount of net profit be described as a small business subject to the 21 per cent rate, then it those circumstances the farmer would have that extra quantity of earnings retained in his business.

Mr. Davidson: The argument that we are putting forward is on the assumption that there is a capital gains tax. If there is no

capital gains tax on land, and some of these other provisions are taken out, then there is less need for the retirement provision.

Another matter that is becoming a very major concern to our members is the whole question of the valuation day. If there is going to be a capital gains tax on land then they are concerned about what happens if a family holds a farm for two generations, and in 50 years' time they sell the farm and there is a capital gain. According to the White Paper they would then have to face the question of how they value it 50 years back. Who will win the argument, and who is going to make the decision?

The Chairman: The White Paper proposes a valuation date, and you are supposed to determine the value at that date. The value must be considered in terms of an attempt to assess the market value at that date. The basic difficulty in respect of farm land is that the field of purchasers would be very small, and the question is one of whether it is practicable to have a valuation date, and, therefore, to have a system of capital gains taxation to apply to farms and the sale of farms so long as their use as farms continues.

Mr. Davidson: This is exactly the point. Since the White Paper does not give us any details as to what will be the method of valuation we are concerned about what will be accepted as a method of valuation. Will it be good enough for me to send a letter by registered mail to the Minister of Finance saying: "My total property is worth this much on valuation day, and if you do not like it please let me know within three months. If I do not hear from you I am going to assume that you accept this valuation forever"?

The Chairman: Mr. Davidson, if you are asking me, or any other lawyer who is a member of this committee, for an opinion as to whether that is the basis, then the answer would be a thundering No.

Mr. Davidson: I am sure you are right, but we are concerned about what would be the basis. We do not know, and we have 50,000 to 70,000 farmers in Ontario who are wondering whether they should try to find a farm assessment expert to value their property between now and valuation day in order that they have some official figure to put forward to prove their point.

The Chairman: Perhaps your organization should establish a valuation section.

Mr. Davidson: The problem is that the current cost of having a valuation done on a farm is somewhere $700 and $800, and there are only fifteen competent and recognized men in the Province of Ontario who can do this job. There is no chance of the farmers of Ontario getting this job done before 1975 at any reasonable cost.

The Chairman: Just imagine how many pictures and pieces of antique jewelry there are in Canada at the present time.

Mr. Davidson: It is a frightening thought, but again...

The Chairman: It is so frightening that it is ridiculous, is it not?

Mr. Davidson: We would like to know what we should advise our members to do between now and valuation day. We do not know and they do not know, and they are concerned. Some method should be outlined that is reasonably easy and economical so as to avoid a major dispute fifty years hence, which undoubtedly the Government will win because it has the resources. So, we say that either a simple system must be devised, or the Government must agree to pay three-quarters of the cost of any dispute in the future, because they have the resources to fight disputes, and the individual taxpayer or the individual small farmer does not.

Senator Phillips (Rigaud): Perhaps you should follow the system of having a study group and holding up the filing of returns until you come to a conclusion. Perhaps you should just keep on studying the problem.

The Chairman: You might gather all the people in a certain area together and have quite a study and analysis, and record their views as to value.

Senator Phillips (Rigaud): Yes, that is the fashion today—keep on studying the problem, and never arrive at a conclusion.

The Chairman: Are there any other points that you wish to make, Mr. Munro?

Mr. Munro: Mr. Chairman, there is the matter of the principal residence, but again it is contingent upon whether we have a capital gains tax or not. Assuming that we do have a capital gains tax then there should be provision for more than one residence on the farm because...

The Chairman: I think it should go without saying that if there is going to be a capital

gains tax there should be a roll-over provision with no geographic limitation such as they have in the White Paper. The proceeds of the sale of the homestead or a residence should be available to be used without tax to acquire another residence.

Mr. Munro: Yes, and, of course, within a family operation there could be two or three principal residences which are used by the father and his sons in the operation of the farm.

Mr. Davidson: I think this is referring to the $1,000 plus the $150 that is being proposed as an annual allowance. The White Paper allows for one principal residence, but on the farm, and particularly on an incorporated farm, there may be two or more principal residences occupied by the farm family who are operating the farm. The taxpayer may not own the principal residence; the incorporated farm may own it. There may be, therefore, no allowance to the taxpayer, as we read the White Paper. What we are saying is that in the situation of an incorporated farm, where there are two or more houses, allowance should be made for that at the rate of $1,000 plus $150. We feel that it is an oversight that this has not been rectified.

Senator Molson: Mr. Chairman, it has been represented many times before this committee that taxation on the principal residence is not a desirable thing. That has been expressed to us by a good many witnesses here who feel that the taxation of a capital gain on the principal residence should not be included.

The Chairman: On either a principal residence or a homestead.

Senator Molson: Would that be your view?

Mr. Davidson: That would solve the problem, yes.

Mr. Kirk: Except that there would be some problem in deciding what the value of the principal residence was when it is part of a farm holding. It would have to be identified in the value of the total unit.

The Chairman: But if there is no capital gains tax on farms then there would be no problem.

Mr. Kirk: That is right.

The Chairman: Are there any other points?

Mr. Munro: Have you anything further to bring forward, Mr. Kirk?

Mr. Kirk: I do not think I have.

The Chairman: Then, thank you very much, Mr. Munro. This has been a useful discussion.

Mr. Munro: Thank you, Mr. Chairman, and thank you, gentlemen. It has been a pleasure for us to come here.

The Chairman: We have better than half an hour left before we adjourn, so we shall hear now from the League of Concerned Canadians. I will ask the chairman, Mr. Locke, to come forward. Mr. Locke is going to make the initial presentation, and he has Mr. Keyes, an economist with him to assist him in answering questions. Would you open the matter, Mr. Locke, by telling us what your organization is?

Mr. C. C. Locke, Q.C., Chairman, League of Concerned Canadians: I thought that that would be the first question. The League of Concerned Canadians is a group of people in Vancouver, and it is basically an organization of a number of business and professional men of all kinds. Their ages range from about 40 to 55, and they are largely from Vancouver, with some from the Fraser Valley and the Island.

In so far the membership is concerned, initially we ask people to contribute money. There are just under 100 who have helped us to defray certain costs. We estimate that there are about another 100 who have undertaken the work in which we originally engaged. That is, writing to Members of Parliament and senators concerning the problems we raised in our presentation.

This is an organization composed entirely of individuals. The brief is presented by people as individuals. We are not affiliated with any professional or other organization or any political party.

It is very largely a group of parents. The organization was originated by two or three people who were very perturbed, which is a mild word, about the effect the White Paper proposals would have in particular upon their children. It appeared to us that there might be very great inducement for them to leave the country, which we do not wish them to do.

That, literally, is how the organization got started. Since tht time we have recruited people by telephone, friendships and letter-writing.

The presentation is devoted very largely, in fact almost completely, to those very few pages of the White Paper which are devoted to the economic effects upon Canada. I do not suppose you have had much comment on them before, but it is to be noted that only at pages 90 to 95 of the White Paper does one find any statement with respect to the suggested economic effects upon Canada.

The League's central submission to you is that the information displayed for you in particular as members of our Government as to the economic effects on Canada is scanty. We suggest that you do not have all the information that you would require before you come to decisions in these important matters. The submission is directed towards these economic effects of the White Paper.

I can only refer you, first of all, to the summary on page 16 of our submission. I will just read very shortly from the ending of the brief:

> The League of Concerned Canadians believe that a much more cautious approach to tax reform is in order because the proposals put forward in the White Paper may well harm:
>
> 1. our rate of economic growth,
> 2. our ability to attract capital in world markets,
> 3. our ability to generate capital from internal private sources,
> 4. our competitive ability to trade with other countries,
> 5. our ability to retain our talented and productive people, educated at Canadian public expense.

To elaborate very briefly I turn to the top of page 7 of our submission:

> It is our view that it is better to err on the side of economic growth than to "plump" for the virtue of a fair and equitable (in the eyes of the authors) tax system, if it is not possible to predict with reasonable certainty the consequences to the economy of these tax reforms.

Do the senators wish to discuss the reasons for saying this?

The Chairman: Mr. Locke, three or four years ago you had a very good witness to support what you have read. That was the then Minister of Finance.

Mr. Locke: I am not aware of it, but I am grateful for any assistance.

The Chairman: In his budget speech in November, 1967, he stated the different points in the Carter Report about which the public were concerned:

> The first is the sweeping extent of the changes recommended by the commission, and the difficulty of predicting the effects that sudden changes of this magnitude would have on the economy and ultimately on the position of various taxpayers. We have encountered this difficulty ourselves.

Mr. Locke: I thank you, Mr. Chairman, because it is quite obvious, of course, that the Government is still experiencing difficulty.

At page 15 of our submission we refer to the fact that the Government was $239 million in error in an estimate of the revenues of Canada made in November 1969. It does not give one very much confidence in computing the effects of sweeping reforms such as these when we read that.

Senator Benidickson: The Minister of Finance constantly reminded us that one per cent difference in estimating either expenditures or revenues today constitutes a lot of money.

Mr. Locke: That is right.

Senator Phillips (Rigaud): Your brief seems to say that the White Paper *in toto* produces serious results. I do not think you have followed that through by this statement, if I am right in my assumption that you are suggesting on behalf of your organization that this committee come to the conclusion that the White Paper should be rejected *in toto*.

Your submission contains no suggestions as to the major recommendations that might be eliminated in order to make it reasonably acceptable.

Mr. Locke: We have not made such suggestions, senator. We are not by nature a tax organization and did not propose to come forward with a tax reform for Canada.

We went so far as to say that in view of the fact that it is apparently so difficult and perhaps almost impossible to predict the effect of the reforms sought to be implemented by the White Paper that it ought to be withdrawn. This would allow for re-thinking and the collection by the Government of Canada of sufficient economic information to enable you and our elected representatives to come to a sound conclusion.

We believe in truth that it is the paucity of information which is the principal stumbling block. It may very well prove that further and better information would establish that in one way or another the proposals of the White Paper must be altered.

We suffer, of course, from what other people have said. I think that no less a person than Mr. Benson stated that we come forward with nothing but criticism, with no alterntive. I think there is an element of injustice about that.

We are a small organization. Some of us have some skills in this field, but we come forward as individuals. It is very difficult for an individual organization, with no apparatus behind it, to predict what the development of Canada should be. Therefore we have limited ourselves to flashing a great warning light saying that you ought not, please, in our respectful submission, proceed with this without being absolutely sure of where you are going. We believe that you are, I do not want to say gambling, that is too strong a word, but you may be jeopardizing the future of our country in the long term.

Senator Benidickson: As outlined on page 16 of your brief.

Mr. Locke: That is so.

Senator Macnaughton: Why does the witness not read the last sentence on page 16 of the brief into our record of proceedings?

Mr. Locke: I quote the last sentence on page 16 of the brief:

> In other words, we wonder if the government is correct when it states "...they (i.e. the proposals) are the best practical proposals to attain our objectives in present circumstances."

If I may, I should like to elaborate on that. I should like to say something about the entire subject. The authors of the White Paper may be judged modest people if only by reason of the fact that they use the word "modest" so many times. I don't know whether honourable senators have noticed or have had it drawn to their attention, but if you will turn to the White Paper itself, to the vital pages dealing with the impact on revenues and economy, you may see just how many times the word "modest" is used. On page 90, paragraph 8.35, it states:

> 8.35 The tax reform proposals set forth in this paper are expected to have relatively modest impacts upon the Canadian economy apart from the effects on savings...

Page 91, paragraph 8.37. I quote:

> 8.37 The proposals in this paper involve some increases in marginal rates up to incomes of $15,000 or $17,000. These increases may have some modest effect on the incentive to work...

Page 92, paragraph 8.41. I quote:

> 8.41 The impact of the various proposed changes in personal exemptions, individual tax rates, inclusion of capital gains, etc., apart from the items implementing the integration of the corporate and personal tax, would reduce personal savings modestly.

Page 93, paragraph 8.49. I quote:

> 8.49 The general economic effects of these proposed tax changes would include some moderate reduction in aggregate private saving...

Later on in the same paragraph you find the words:

> The most significant factor in the long term would be the moderate reduction in the rate of corporate saving...

Page 95, paragraph 8.50, quoting from the body of the paragraph, in fact, the second last sentence:

> In total, therefore, we expect the result of these tax changes to be a modest reduction of the inflow of foreign equity capital into Canada...

Mr. Keyes and I would point out to honourable senators that, if by any chance the authors of the White Paper are wrong, then there is a very serious error indeed that may creep into the entire economic structure of Canada.

I should like to elaborate on one point more, with your permission, Mr. Chairman. Our organization started out because a number of people, of which I happen to be one, felt concerned for their children. If I may descend to a personal level for a moment, I must say that if it were not for my children I would not be here making representations. But I happen to have children and I am interested in maintaining them in Canada.

It has always appeared to us that those people who make the economy go, those who are the ingenious, the inventive, the people in business, in industry and in professional life,

the people who will stay up until two o'clock in the morning and who will look ahead to their future for whatever their motives might be, those are the people who probably earn from $15,000 to $35,000 a year.

I had the privilege of sitting this morning listening to the brief of the Massey-Ferguson company. Their brief came to me as a surprise. They could be saying what I am saying, I suppose. But in any event I think we ought not fool ourselves in respect of our children, because our children may leave Canada if the inducement is sufficient.

Canada's main asset is its young people. Speaking for myself, a middle-aged lawyer has little mobility. He is where he is. He cannot leave, even if he wants to, and as far as I am concerned I don't wish to leave. But young people can leave, particularly if they are educated in the sciences or in accounting or, for instance, have executive ability. If they are educated in anything which is portable they can leave, and they will leave.

The Chairman: Mr. Locke, I am trying to recall some figures in connection with the young element of the population. I remember that when the national housing people were before us some time ago they told us that the Canadian youth population as a percentage of the over-all population was the greatest of any country in the world.

Mr. Locke: I am sure you are right, senator, although I am afraid I did not look up those figures.

In any event, I just continue that the point is obviously simple, in my respectful submission. The greatest danger posed by the White Paper is the tax imbalance between Canada and the United States. You have had some figures from the Massey-Ferguson company this morning. We have other figures on page 13 of our submission. They happen to be taken from the tax rates of the United States and Canada, involving a resident in Manitoba and a resident in Minnesota, as those two places are adjacent and one might expect that that state would be a place towards which Canadians would migrate. I don't think honourable senators ought to underestimate what is happening in Canada. Undoubtedly you have had other estimates of the situation, but I am personally aware of at least one able young American executive who has left Canada recently. He is in charge of and runs a business in Seattle, instead of running it in British Columbia where he could be. He came to Canada to be a Canadian, but he decided he could not stand the tax rates.

Furthermore, in Vancouver, which is my home city, I know now of Americans who would ordinarily expect to become Canadians but who have been induced to change their minds by what they were pleased to call the "writing on the wall" of the White Paper. They are considering buying places in Point Roberts, which is, as you know that small tip of the peninsula which still belongs to the United States which was severed by the Emperor of Russia those many years ago. You can drive from Point Roberts to Vancouver. They are going to do that so that they can remain American residents. They too are going to Seattle to run their businesses from Seattle. This is actually happening. It is an actual fact right now.

In our respectful submission, Mr. Chairman, no matter how the tax imbalance arises, whether it be through a combination of capital gains tax, income tax and succession duties does not matter; if that tax imbalance is such that our children leave the country, then, that is a sorry situation. If our children go to professional schools or are aducated at Canadian public expense and then go to foreign countries, and we will not be able to stop them, that, in our submission, is a waste of Canada's most precious asset—its young people.

The Chairman: And we would be losing our investment in them.

Mr. Locke: We would be losing our investment in them, yes, and we would be losing the future of Canada.

Instead of creating a climate that is attractive to Americans, because that is where I regard the principal "cold" threat, if I may use that word, instead of creating a climate that would attract Americans to Canada with their magnificent managerial skills, inducing them to become Canadians and helping to educate the Canadian managerial pool, instead of doing that we are doing the reverse, we are doing exactly the wrong thing. We are creating a climate which is inducing Americans to leave Canada rather than to come, and we are therefore losing the advantage of their income, their skills and their teaching abilities. In our view it is exactly the wrong approach to the situation.

I do not think I can add very much more, Mr. Chairman, except to say that again in the eyes of some of us the greatest single threat

posed by the White Paper is the loss of our young people.

As far as other points concerning the raising of capital and soon are concerned, you have perhaps heard enough already from other groups, so I will say nothing more on that.

Senator Phillips (Rigaud): Mr. Locke, because of your standing, particularly to those who know you well, you will realize that we have listened with great interest to what you have had to say. However, I still press the point that in my opinion we are facing a problem of the White Paper being, if not a letter of intent, at least an indication of things to come. I do not think your request will translate itself in reality in terms of the withdrawal of the White Paper.

Before you leave I should like to ask you this question. I know the conclusions in relation to children and so on, which you have stated so ably, but what aspects of the White Paper bother you most? Is it integration? Is it capital gains? Is it the attack on the extractive industries? Is it the failure to allow small businesses to build up capital? In what order would you place the projected legislation from the point of view of the results it would produce, to which you refer? I know you have not prepared a brief as a tax lawyer, and that sort of thing, but it would be very helpful if, having read the White Paper, you could tell us what hurt you most.

The Chairman: You might add to your list the higher personal income rates.

Senator Phillips (Rigaud): That was implied by the result of the children leaving the country, or the danger of it.

Mr. Locke: Not to state the answers but to put the problems perhaps, the first we see is that it will diminish our rate of economic growth by making it more difficult than in the past, and conceivably impossible, to raise capital. The flow of capital that is needed in our country will be cut off, because there will be a decrease in savings from the private sector of the economy by the higher tax rates which it will drain off. For instance, the taking off of the small business tax will inevitably mean the pool of savings is less. Secondly, the Government will get more money. In order to replace that pool of capital, presumably the only way of replacing it, or one other way of replacing it, is for the Government to put it into the economy, which seems rather difficult to believe, that the Government will supply the economy with the money to develop industry.

The only other avenue of raising capital we have is that of foreign investment, and some of the recommendations of the White Paper appear to discourage foreign investment. Even, for instance, the tax on resource industries will make it less attractive, and the question of the withholding taxes from other countries will impede, or partially perhaps cut off, that flow, so the first great effect will be a decrease in capital flow leading to development.

The second point, of course, is that of personnel. In so far as the flow of people is concerned, the next great effect, in our opinion, is the increased tax burden by one means or another upon the productive people group, the class of whom I have spoken. This is the greatest effect. You will ask, of course, how we get the money back if we are going to get this. I somehow feel confident that an analysis of the numbers will show that if the upper portion or a portion of those people were releved of the extra tax burden the country would not suffer perhaps in total as much as some people have said. We are not skilled and have not enough statistics to eleborate that, but that is the second point.

I would like to ask Mr. Keyes to speak about the lack of information of government plans, and about the relationship of the federal and provincial governments, because he is much more skilled in this than I am.

Mr. R. Keyes, Economist, League of Concerned Canadians: Mr. Chairman and Senator Phillips, addressing myself to your question . . .

Senator Phillips (Rigaud): And be good enough to include provincial governments, to which Mr. Locke referred.

Mr. Keyes: Yes, I will. As a matter of fact, I am chairman of the School Board of West Vancouver, and am well aware of the municipal revenue implications of this White Paper which concern me greatly.

What worries me as an economist is, when you look at this without the resources behind a large group of people—and you have had many expert witnesses appear in front of you—I see the implications of this White Paper doing one major thing: that is, a transference to the government sector of the growth of the Canadian economy. If you go through the proposals in standard economic analysis it will be found that the tendency

will be for private spending to increase and private saving to decrease, at both the personal and corporate levels.

If the authors of the White Paper are correct—and as Mr. Locke suggested, we ask you to examine very carefully whether indeed you feel they are correct—that the proposals will have a "modest" impact, then you must assume that the gap that will be left by the savings and investment sectors of the economy, because of the drop in savings and investment incentives, will have to be picked up by the government sector. Personally—and you have asked me to comment personally—I find that distasteful for myself and my children in the future in this country. I see that as a danger.

The other aspect is that the White Paper authors have made tax proposals, but I think they have been deficient in not projecting on the future growth of government revenues at all levels of government. Certainly the federal Government's share of the gross national product is declining, and to all intents and purposes, if the forecasts we have read are correct, will continue to decline. But it is not the federal Government sector that will grow. It is the provincial and municipalities demands for funds that will grow in the future. I therefore think that we should secure—if I may be so bold as to suggest this to you sir—a forecast of expenditure as against the revenues that will be produced by the White Paper proposals as they will exist down the road. I think the implication of that might very well lead one to the conclusion that it would be very difficult for the federal Government to hold the 50 per cent maximum marginal rate as the demands of the provincial and municipal governments come before you. I do not know whether I have answered your question.

Senator Connolly (Ottawa West): The witness is concerned about the maximum rate proposed by the White Paper, and the difficulty of maintaining that line. If a great emergency arose in the country, such as the need to increase the defence expenditures very substantially to contain, with our allies, a potentially explosive situation, where huge amounts of money might be required, what would he think about the prospect of getting the kind of revenue necessary to do that?

Mr. Keyes: I think the 50 per cent marginal rate would go by the board very quickly. This is the point I am making, that the fairness and equity aspect is the one that is the most tenuous in the entire White Paper.

The Chairman: Is it fair to make the calculations that are made in the White Paper on the basis of a 50 per cent rate?

Mr. Keyes: Well, I leave that to your conclusion, sir.

The Chairman: First of all, there is not such a thing at the moment.

Mr. Keyes: No, there is not.

The Chairman: So it is a projection. Secondly, if a calculation is to be made on the basis of a floating but reducing rate of personal income tax from 82 per cent odd down to 50 per cent over a period of five years, that phase of it, can you have any confidence or reliability that that can be done?

Mr. Keyes: I would think in the situation that Senator Connolly suggested, political pressures to change, if it was possible to do so, would be very strong and it would go by the board.

The Chairman: I just point out the other fact. I read you an exerpt from the budget speech which the Minister of Finance made in November of 1967. Everything he said in that speech is being said to us during our hearings, and yet the White Paper proposals which we are considering are exactly the opposite from what the previous Minister of Finance said. In both cases it is government policy.

Mr. Keyes: Mr. Chairman, without showing any disrespect and perhaps injecting some humor, the Honourable Mr. Sharp is an economist and the Honourable Mr. Benson is a chartered accountant.

Mr. Phillips (Rigaud): Perhaps the best way to handle the situation with respect to the 50 per cent rate would be to ask for an amendment to the Bill of Rights so that we have such a constitutional guarantee as to rate.

The Chairman: I think you are the one who suggested to Mr. Bryce that if he wanted to make assurance doubly sure that he undertake to amend the Constitution, but he thought that was out of his hands, and I am sure it is.

Senator Burchill: President Nixon had to change his opinion just the other day, did he not?

The Chairman: That is right. Gentlemen I want to thank you very much for coming here today.

The committee adjourned until 1.30 p.m.

Upon resuming at 1.30 pm.

The Chairman: Honourable senators, I call the meeting to order. We have our final brief for today. It is from the Montreal Kiwanis Club and Mr. Flummerfelt is here to make the initial presentation. He has fortified himself with a panel, in case he may run into rough water. Then, he will be able to turn to them for help.

Mr. J. R. Flummerfelt, Vice-President, Kiwanis Club of Montreal): Mr. Chairman and honourable senators, first of all I would like to say, on behalf of the Montreal Kiwanis Club and the other clubs which are represented through the Montreal Inter Service Club Council, that we are deeply appreciative of the opportunity simply to be heard on a subject of importance to us.

Some time ago an address was given in Toronto by the Honourable Mr. Benson, at the Toronto Kiwanis Club, which is a downtown club. In a more or less jocular manner, it was indicated that if any person who might be attending thought he might be able to make a deduction as a result of hearing the minister, that he might forget it. It is difficult, sometimes, to know what is in jest and what is serious. We had read the White Paper, which had been presented to the House, and in it we found certain quotations, which are found in that White Paper and which have been provided to you.

You will notice that does not identify the service clubs as such, in the categories which are in question. I am referring particularly to "social and entertainment" clubs—in which case the White Paper makes suggestions that the expenses that appertain to membership—and, possibly, meals—that are paid by corporations and individuals, might from this point be no longer admitted.

There is another section which deals with the subject of the investment revenue of social and entertainment clubs, in which there will be a restriction by having those revenues how subject to income tax, where in the past they may not have been so.

Therefore, our first object, honourable senators, is really not one of criticism, it is not one of taking issue with the principles behind the White Paper. Rather, it is one of communication, and only communication. Our primary object in being here is, first of all, to establish that we are not a "social and entertainment" group of organizations, in the Kiwanis Club and in those other clubs which may be of a parallel structure, such as we might find in the Rotary Club, the Kinsmen's Club, the Optimists, the Actors' Club and many others which are in the spectrum of service clubs in Canada.

I think it is significant that when this subject was first explored between clubs there was a spontaneous and keen interest in what the impact of a tax position might be should it affect the membership of organizations across Canada. That interest was sufficient that an exploratory body was set up in Montreal with a group that arose because of the emergencies of Expo. It is known as the Inter-service Club Council. The result of Expo was that we had the size of a project which was greater than any one organization could possibly handle; we had the opportunity for a type of co-operation and civic and national endeavour that could have great importance; and out of this came something that was a very wonderful experience for all persons concerned.

When the problem that might possibly arise as a result of the White Paper being implemented was analysed, and the question was whether it would be adverse to the service clubs of Canada, it was an interesting thing to all of us that there was a complete unanimous endorsement of the brief that was drawn up at that time, and the main heart of that brief is in front of you today. It is accordingly my pleasure, because of that interest, to indicate its representation by having Mr. Sydney Benjamin, who is a past President of the Montreal Inter-service Club Council and past President of B'Nai Brith and a chartered accountant in Montreal—if I might just introduce you, sir, we are pleased to have you with us. Mr. Raymond B. Allen, Past-President of Kiwanis who has flown from Owen Sound to be here this afternoon; Mr. Benoit Parent, past District Governor of the Optimist International, living in Ottawa; Mr. Ed. Twizell, past President of the Montreal Rotary Club and a very interesting man from the plumbing and heating business with a very practical background, who is a resident of Montreal; Mr. Willy Desnoyers, Lieutenant-Governor, Kiwanis Club, a retail shoe merchant with five stores centering out of Granby, a man who is 72 years young, presently the O.Q.M. Lieutenant-Governor and just a wonderful guy.

On behalf of these gentlemen the particular concern that seemed to just flow in our car as

we were coming was that we would not allow ourselves to get locked down into the nuts and bolts of just this particular legislation, but rather to get the feel of what caused the service club movement in Canada which originated back at the time of the first world war in particular, and what it is doing today, the change that has had to take place in order to be in gear with the times in serving our function and then to take a quiet look at the future, wondering if our story is actually known by ourselves because we ourselves are just in the process of trying to create policy to be equal to what we see in the years ahead.

We also would like to express the regrets of Mr. Julius Briskin who is current President of the Inter-service Club Council who was called upon by the mayor of Montreal to attend a meeting in Montreal this afternoon. He has been very active in helping prepare this paper. I would also like to mention Mr. J. Wilson, Secretary of the Inter-service Club Council.

If I may just hit the highlights of this paper and then make remarks at tangents, honourable senators, the first basic thing we would like to say is that we do not feel that the service club dues and luncheon expenses that are pertaining to service clubs can be considered as belonging to something that is a social club or an entertainment club. Perhaps the most practical thing is to ask how many people among the Senators present are presently members or past members of service clubs.

The Chairman: I don't think that is necessary.

Mr. Flummerfelt: It would help to limit my comments.

The Chairman: No. Just go ahead with your remarks.

Senator Phillips (Rigaud): Mr. Flummerfelt, if I may interrupt you, I think the members of this committee are reasonably familiar with the type of activity of clubs such as the Rotary and the Kiwanis Clubs. It would be imposing on your time if you were to develop that aspect unduly. Our job is to deal with the subject matter of the White Paper and its effect upon the deductibility or non-deductibility of dues that are paid. Possibly you might also want to deal with the taxability or otherwise of the income of the service clubs. Without wanting to shorten your presentation, I must say that every senator here has read your brief and you can take it for granted that the citizens of the country know all about these clubs. We know something about Kiwanis and Rotary and, speaking for myself, it would be more helpful and constructive if you would direct yourself to the subject matter of the White Paper itself and the issues involving deductibility or otherwise of the dues.

Mr. Flummerfelt: Excellent.

Senator Phillips (Rigaud): Would you be good enough to do that?

Mr. Flummerfelt: Thank you.

Senator Phillips (Rigaud): Are you directing yourself now to the income of service clubs?

Mr. Flummerfelt: I was trying to refocus it so that I could crystalize the pattern I was thinking into and make it a logical pattern. If we think then, first of all, about the functional position of the service club and our future in terms of our ability to survive, I think this is our first basic question. Our survey indicates that it is between 60 and 65 per cent at minimum of the membership which is based upon the corporate support of various personnel that they may have engaged in various types of service clubs. The very fact that a corporation is presently showing this degree of social consciousness and civic responsibility is a very important factor in helping to make the Canadian way what it is. The question is—will this proposed tax amendment affect this relationship and the responsibilities which are being carried by service clubs, as we see it?

Now, if as a result of there being an interpretation that service clubs do come within the category of a social or entertainment organization, we will be faced by two problems; first of all, we have to recognize what has happened to the membership of service clubs as a whole in Canada during the past ten years. We are all conscious of the merger parade. This means that fewer and fewer people are representing larger and larger work organizations, and when a person, as a condition of membership, is under a classification according to industry, it reduces the number of persons who can be actually members of an organization unless there is a change of constitution that can find new ways of solving these problems. And the service clubs have in general tried to follow a pattern which is consistent with the original concept that there would be a meeting place through

the service clubs by which industry could speak and there could be a meeting ground between business and labour, business and government, business and the social community and between businessmen themselves. To this end, if the clubs are deprived of the right of expenses, the question is: does the Government actually encourage a policy in which the clubs should withdraw from civic responsibility?

The action would seem to suggest that this might be so at a time when there is a greater and greater need to fill the gaps in communications that exist between people. If the membership should drop by 50 per cent, that is the end of service clubs, and at the present time we find ourselves with approximately 70 per cent of what they were ten years ago, and at the same time realizing that we are doing a bigger financial job today than has ever been done in Canada by service clubs. This means that more work is being done today by a smaller number of people than has ever been done before by service clubs. Reduce that number of people by a tax policy which will reduce membership and you will be reducing the social function we provide as well as the many other business functions which are important to this country.

The Chairman: Would you describe the social function? Just one illustration would be sufficient.

Mr. Flummerfelt: Yes. As you know, Montreal is a city composed of ethnic groups. We have a tendency at the present time on the part of the Italian section to move into its ghetto, and the same applies to Hungarians and the various other ethnic groups. They tend to revert back to themselves rather than becoming part of the mainstream of the community because of certain patterns which developed during the past few years. A particular incident of last year has perhaps accelerated this tendency. So the Montreal Kiwanis clubs sat down and said "this is not good; it does not create the climate of co-operation and civic attitude and national attitude that we feel is consistent with a good climate of thinking and working," and so we set out on a policy to invite representations from leading people in the Italian, Japanese, Chinese and other communities. Immediately we threw in a Japanese type of meeting, Japanese girls, Japanese music and the bit. It had a very extraordinary effect and when you get firms of the size of Mitsubishi and others being now represented within the group, you realize you have a linkage that is a part not only of the local, but of the provincial, the national and the whole international scene. A similar thing was done with the "France Day" only a few weeks later, and this is the kind of thing that is happening there.

On the other side, we sit at our breakfast this morning and read that:

> There are 14,000 beds in Montreal's old age homes to serve an elderly population of 300,000.

There is a critical need for this here.

I am proud of the job that an organization such as the St. George Club has just completed with an old folks' home for which they raised the capital, with the co-operation of Government and so on, but somebody had to take the ball; and other organizations that are causing the building of or assistance to such organizations. I think in terms of the thousands of hot meals that are being served at the Negro Community Centre and other places throughout the province, and in particular in Montreal.

Senator Phillips (Rigaud): By whom?

Mr. Flummerfelt: The Kiwanis and some of the other clubs.

Senator Hollett: What paper is that?

Mr. Flummerfelt: This is the Montreal *Gazette* of today's date.

When you consider the number of children who are in the underprivileged group, we sometimes write them off because we do not want to listen to what we do not want to hear, but we have within our group persons who are qualified to tell you the story of the retarded children and what has been done by service clubs in this area, which is a specialized area in itself.

We have vocational guidance being provided through Rotary, Kiwanis and other organizations in the province, so that there will be opportunities for young people to talk with persons who are at various levels of experience in each type of career. This too is part of removing the uncertainty and fear of youth.

There are further evaluation meetings which have been taking place and, in particular, one meeting was held last week in which the youth themselves said, "We are not as concerned now about vocational guidance as we are about personal guidance." In other words, they are floundering a bit, there is an emotional vacuum in there somewhere, and there is an area of wanting to do things, to

harness their energy constructively. Direction and purpose are needed. Many of them would like to be given guidance as to how to get on the track and take a positive role. When the young people suggest that there needs to be practical people, who are not just doctors and ministers, to whom they can simply talk, then this is a role that the people in the service club area can play, and by reference they can pass along assistance and guidance by calling in specialists as required in Montreal.

Senator Phillips (Rigaud): I am sorry for interrupting you, Mr. Flummerfelt, but I think we are back to where we were before. We are generally familiar with the type of work you are doing, but I should like to ask you whether there is any report of the activities of service clubs generally, or some booklet or document, that indicates in summary form the nature of the work you do. If we have that then it, together with your brief, will give us sufficient guidance as to the nature of your operations. Would your bylaws indicate that?

Senator Macnaughton: Or your annual report.

Mr. Flummerfelt: We have an annual report.

Senator Phillips (Rigaud): Yes, if we have the annual report for the last year of the constituent service organizations for which you are the spokesman today, then I think it would be very helpful. It would save you considerable time and effort in explaining the work that is done. Would you provide that for us?

Mr. Flummerfelt: Yes.

Senator Phillips (Rigaud): You do file annual reports, do you not?

Mr. Flummerfelt: Yes.

Senator Phillips (Rigaud): Would you enumerate the organizations whose reports you will file?

Mr. Flummerfelt: There are nine organizations that are within the Inter Service Club Council.

Senator Phillips (Rigaud): Would you state for the record what you are agreeing to file, and then you can move on to the particular features of the White Paper.

Mr. Flummerfelt: Perhaps I might ask the past president of the Inter-Service Council to name them.

Mr. Sydney Benjamin, Governor, Inter-Service Club Council: They are B'nai B'rith, Civitan, Canadian Progress Club, Kinsmen's Club, Kiwanis Club, Lions Club, Optimist Club, Richelieu Club, and Rotary. I believe there are nine there.

Senator Phillips (Rigaud): Are there nine annual reports available?

Mr. Benjamin: I am not sure, but I imagine that five or six would have a summary of the activities.

The Chairman: That would give us something tangible to look at, and it would be part of the record. Will you see to it that we get that?

Mr. Flummerfelt: Yes.

The Chairman: Then you can assume that we have that knowledge.

Senator Phillips (Rigaud): May I, Mr. Flummerfelt, assist you in your presentation by drawing your attention to page 4 of your brief, at the bottom of which you indicate the estimated tax revenues by disallowing service clubs dues and luncheons amount to $4,787,881.

Mr. Flummerfelt: Yes.

Senator Phillips (Rigaud): That is specifically applicable to the service clubs to which you have referred?

Mr. Flummerfelt: Actually, it would include what we believe to be the total spectrum of all service club organizations.

Senator Phillips (Rigaud): By service club organizations do you mean organizations similar to Kiwanis and Rotary?

Mr. Flummerfelt: Yes.

Senator Phillips (Rigaud): And not necessarily represented by you and your colleagues here today?

Mr. Flummerfelt: That is right. It is the total national picture.

Senator Phillips (Rigaud): You are part of the membership of 135,000?

Mr. Flummerfelt: Tht is correct.

Senator Phillips (Rigaud): So that this committee is being asked to consider the advantages and disadvantages to the national treasury's losing $4.7 million annually as against

the accumulated valuable social effect of the services you are rendering to our fellow Canadians?

Mr. Flummerfelt: That is correct.

Senator Phillips (Rigaud): Is not that the pith and substance of your case?

Mr. Flummerfelt: Yes, sir, that is the heart of it.

Senator Phillips (Rigaud): It is more than the heart. Is that not it?

Mr. Flummerfelt: No, not entirely, sir.

Senator Phillips (Rigaud): Is there anything beyond that?

The Chairman: What is the other point?

Mr. Flummerfelt: As you finish this there is still something that you will find not said, and that is: What is the Canada that we are leading to? What are the problems that we will be facing? What are the challenges that flow from this that somehow have to be translated into expanded services rather than decreased services?

The Chairman: Do you not think, Mr. Flummerfelt, that we have some appreciation of that?

Mr. Flummerfelt: I do not doubt but that you do, sir, yet this happens to be, perhaps, the first time that service clubs as such have tried to express a collective thinking here, and I feel that just on that ground alone, we should have the right to comment on certain things.

Senator Phillips (Rigaud): I am the last one in the world not to give you that right, but I am drawing your attention to the fact that jurisdictionally our problem is to deal with the subject matter of the White Paper on taxation, not the general or social aspects or activities of social clubs in Canada. And, on the basis of being reasonably familiar with it, our jurisdiction is confined to the subject matter of taxation.

Senator Connolly (Ottawa West): Perhaps it might be helpful if we ask the witness specifically—what aspects of the White Paper, do you think, adversely affect you?

The Chairman: He mentioned that earlier—it is the dues, which it is proopsed to disallow as a deduction.

Senator Connolly (Ottawa West): Has he confined it to dues?

The Chairman: No, there is also the other aspect. Do you have any funds invested that produce income?

Mr. Flummerfelt: We have, in certain organizations, foundations which have been created because of the insurance policies or small bequests that members will arrange through their estates, for the continuance of assistance to camps and other various projects. It is a question of whether it is practicable for persons to continue to make such gestures, when this could be a growing basis of reducing contributions by the members.

Senator Connolly (Ottawa West): Surely, on that point, you would have to reconsider this? If you get a bequest and you get the income from the capital of that bequest, you are a non-taxable, non-profit organization. This does not create a financial problem for you?

(Senator Phillips (Rigaud) In the chair.)

Senator Benidickson: Mr. Chairman, it was agreed this morning. .

The Acting Chairman: Excuse me, senator. Was that question answered, Mr. Flummerfelt?

Mr. Flummerfelt: I can answer it in two ways. The first is, an organization which has a foundation would be presumed to operate within a charitable structure as such and any revenue that might be in that area which would be generating profits to be put to work in charitable purposes we presume would not be within the jurisdiction of the White Paper.

Senator Connolly (Ottawa West): The White Paper does not touch them.

Mr. Flummerfelt: No, that is what I am saying. If there should be a broader base where there is money left to a service club for its broader implementation for policies which cannot yet be defined, and should there be a broader base, we would find that that might be taxable if it were treated as a "entertainment or social club". Our position is that we do not wish to be classified as a "social or entertainment club", partly because we are not, essentially because we are not, but also because of the tax.

Senator Connolly (Ottawa West): But at the present time it is admissible as a tax deductible.

Mr. Flummerfelt: Provided that the money is put into our charitable foundation. Perhaps you would like to speak on that, Mr. ...

Senator Benidickson: Mr. Chairman, my point was that we had agreed this morning that we would be able to go into the house before Orders of the Day are called.

The Acting Chairman: I am sorry, senator.

Senator Benidickson: The delegation will understand that the Senate convenes at 2 o'clock and it is necessary for us to be there. I know what emphasis you put on attendance. We have to be recorded as being available. We could be back very shortly, to hear the delegation further.

The Acting Chairman: We must suspend this hearing for about 15 minutes, to report to the Senate.

Senator Macnaughton: Mr. Chairman, may I ask one question. Is it not one of the nubs of the question, that your organization feels that it is picayune of the Department of Finance to talk about disallowance of fees and even the cost of a meal, in view of the tremendous charitable contribution that you make to the development of this country?

Mr. Flummerfelt: That is quite so, senator.

Senator Macnaughton: May I just make a short correction to the last question. I used the word "charitable". I believe a better term was what our friend said, "community effort".

Mr. Flummerfelt: Perhaps I might also make a clarification. Donations which are received by service clubs in Canada are used for charitable purposes only. Operational costs are maintained only by themselves. Any fund which may be left by the clubs are strictly left within the fund. Senator Connolly, raised this question, and I would like to say that money left to charitable funds should not be affected by the White Paper as it applies in this case.

The Acting Chairman: I agree. I do not think that the White Paper proposes to take away that exemption at the present time.

Mr. Flummerfelt: Well, it does establish for the social entertainment clubs that there will be income tax on investment income.

The Acting Chairman: I raised that question before in your presentation. You were dealing with two problems: (1) the question of the non-deductibility of the club dues that were paid and (2), the subject matter of your investment income. You remember I asked you that?

Mr. Flummerfelt: Yes.

The Acting Chairman: I think for the present you are directing yourself to the fear of non-deductibility of your club dues.

Mr. Flummerfelt: That is correct.

The Acting Chairman: We will go onto the other one later.

Senator Connolly (Ottawa West): What is the average level of club dues per annum.

Mr. Flummerfelt: This will vary according to the community. If two thirds of all service clubs are outside major cities, you will find that the level of dues will be smaller in those communities than perhaps in the cities of Toronto, Winnipeg, Montreal, Vancouver, and so on. It is not unusual in the larger cities to have a fee of $200 or $180 which will cover the operational costs of the club for its office and administration service and a portion of the meals. In some cases all of the meals will be deducted throughout the year, and in other cases only a portion of them.

Senator Beaubien: On page 4 you estimate dues and meals at $150 a member.

Mr. Flummerfelt: That is why I say the average. I do not expect it to be more than $150 by our findings. Would you concur with that?

Mr. R. B. Allen, Governor, Kiwanis Club, (Ontario, Quebec, Maritimes): I would say that the average fee in the Kiwanis Club is $45 plus meal charges.

The Acting Chairman: Is that money used for administrative expenses or is any portion used for social services, or is your social service income dependent upon legacies and gifts?

Mr. Flummerfelt: The social services actually are financed by our service clubs and are partly financed by our dues, because we have to have administration units in which to coordinate. We also have to raise money through various projects.

In my car I have a carton of maple syrup. In Montreal we raised $10,000 to provide for eight little leagues. If you had seen Mr. Benjamin only two weeks ago you would have seen him with a boy's hat on at the little league kickoff in Montreal for its twentieth year. That is the answer, I think.

Senator Connolly (Ottawa West): I suppose you issue receipts for any charitable donations you receive, but I take it that the funds you receive from special projects are used for your social development work?

Mr. Flummerfelt: Only for that purpose.

Senator Macnaughton: Do you have any invested funds or any carryover from year to year?

Mr. Flummerfelt: It is necessary to have a certain account in order to be able to carry you through your administration and budget pattern. I would judge that a 15 per cent factor might be a normal working capital position.

Senator Macnaughton: They are not substantial?

Mr. Flummerfelt: No.

The Acting Chairman: In paragraph 4 you refer to total possible expense deductions of $20,250,000, for all the service clubs in Canada. That is your estimate of the gross income of all service clubs?

Mr. Flummerfelt: That is right.

The Acting Chairman: Now, my question is: what percentage of that amount is used as direct service to beneficiaries as distinguished from mere office maintenance, directors, personnel, and that sort of thing? You surely do not spend twenty and a quarter million dollars running offices and paying directors. I would say that the views of honourable senators would be influenced somewhat by knowing what portion of the income goes back in terms of services to the underprivileged and the like.

Mr. Allen: In the Kiwanis, and I can speak only for them, we operate on a two-fund structure, a service fund and an administrative fund. All moneys raised through our projects are on deposit in our service fund and 100 per cent of this money is spent in community service. Fees that the members pay are obviously in our administrative account and are used to operate the club.

The Acting Chairman: Would that mean that service clubs collect $20 million in fees and this revenue is used exclusively for administrative purposes and non-social services?

Mr. Allen: I am confused by the word "fees". I would understand fees to be membership fees.

The Acting Chairman: Yes.

Senator Benidickson: Does this figure include meals.

Mr. Flummerfelt: Dues and meals.

Senator Benidickson: If the cost to a member for a whole year period of his association with one of these clubs is, on an average, $150...

Mr. Flummerfelt: If you have $40 to $50 for a sort of budget to be paid for from dues for your office maintenance and your co-ordination of services, and so on, the balance of that average of $150 is for the meals related to the weekly functions. There has to be a mandatory attendance up to a certain level as a requirement for membership.

Senator Connolly (Ottawa West): What you are saying is that one-third of $20 million apparently would go for administrative costs, and the other two-thirds would be for social service work.

Mr. Flummerfelt: The other two-thirds represents meals, sir.

Senator Beaubien: One-third of the $20 million would be spent on social service?

Mr. Flummerfelt: No.

Senator Connolly (Ottawa West): One-third of the $20 million, as I understand it, is spent on administration and two-thirds would be the item to cover the meals.

Mr. Edward Twizell, Past President, Montreal Rotary Club: This is approximately correct.

Senator Connolly (Ottawa West): Because all the meetings are meal meetings.

Mr. Twizell: And all moneys for charitable and community service is collected beyond that in different ways.

Senator Beaubien: Nothing to do with the $20 million.

Mr. Twizell: No.

The Acting Chairman: Is the argument that the meals should be included in deductibility because that is the way of bringing your people together, launching them and keeping them at their work?

Mr. Flummerfelt: A very definite requirement.

Senator Macnaughton: Over and above the $150, one-third administration and two-thirds

meals, you probably each spend $200 on gifts to this and contributions to that. Therefore the $150 is a bare minimum.

Mr. Flummerfelt: It is peanuts. On page 5, under section (c) in the brief you will find part of the answer to the last comment. There we speak about cash benefits to Canadian communities per year through service club activities. The members themselves on the average spent not less than $50 each. This produces $6,750,000 more of social benefit when you add that to the one-third of the $20 million.

You started by saying we have one-third of the $20 million as an administration cost to support the things we are doing and two-thirds to meals. Added to that is the additional sum of personal contributions, $6,750,000, that the men themselves give out of their own pocket. That is still really only fractional in relation to the whole picture.

We are not in the money raising business today. This is the great change of the service club movement.

The Acting Chairman: Mr. Flummerfelt, at page 5 of your brief your evaluation of Canadian service clubs, national and international, is given in paragraph (c). The contributions that you make, personal donations to club projects, capital fund raising activities, total $17,550,000.

Mr. Flummerfelt: Correct.

The Acting Chairman: If those amounts are given by individuals, to simplify my question, they are already deductible as long as they are within the 10 per cent taxable income of the donor. If they are given by corporations they are within the 5 per cent deductibility of the corporation. Is that not so?

Mr. Flummerfelt: No sir, because nobody gets a deduction for buying maple syrup or apples.

Senator Connolly (Ottawa West): That is right, that is the capital fund raising activity. However, Senator Phillips, I am sure, is referring to the personal donations to club projects of an average of $50 per member.

If that money is to be used for the social, charitable and educational work carried out by the club, do you not issue a receipt to the donor?

Mr. Flummerfelt: We do.

Senator Beaubien: And he uses it in his income tax.

Mr. Flummerfelt: He does.

Senator Welch: Is that deductible?

Mr. Flummerfelt: If they have a charitable foundation for that purpose. This is one reason why a number of clubs have formed this, but where there is no charitable organization they do not hold a licence number and this would not be deductible unless they treated it as sales expense rather than a donation.

Senator Connolly (Ottawa West): In any event, this is not a problem arising out of the White Paper.

Mr Flummerfelt: The White Paper does not change that at all.

Mr. Twizell: It is the fees and the meals. With respect to the cost of the meals, all clubs have to have a place to meet. I think part of the cost of the meals is the rental of the hall. In our club we pay $3.50 for a $1.25 meal, but we have to pay that difference to have a place to meet.

I want to be sure that you do not think we are going out and having fancy meals at the expense of the country. Most of this is in a hotel, where you have to have a place to meet.

Senator Macnaughton: Senators might do that, but certainly you do not care to be the type.

Senator Carter: In the second part of section (c) you multiply total membership by $80. Is that the actual average capital raised per member?

Mr. Flummerfelt: Yes, that is our estimation.

Senator Carter: That is what you estimate to be the average?

Mr. Flummerfelt: It could be much higher than this. Our problem, sir, is that this is the first attempt to co-ordinate information of all the service clubs of Canada. It will take us at least a year before we can provide your group with the true story.

We had anticipated the suggestion of Senator Phillips, but it will require many annual meetings and statistics in order to provide the correct story.

We know in the Montreal area that the contributions are actually higher than this. I am not so sure of the townships, Mr. Desnoyers. The contributions are raised, or capital

funds at $80 per member. Is that too high or too low for the small units?

Mr. W. Desnoyers, Lieutenant Governor, Kiwanis Club (Ontario, Quebec, Maritimes): Do you mean the money that we collect from the public?

Mr. Flummerfelt: Yes.

Mr. Desnoyers: That is a conservative amount.

Mr. Flummerfelt: What would you say it is?

Mr. Desnoyers: I gave you the figures of last year, where it was something like many, many thousands of dollars collected.

Mr. Flummerbelt: It is sufficient that you are satisfied that this is conservative from your point of view.

Mr. Desnoyers: It is very conservative.

Mr. Flummerfelt: Mr. Parent, is this conservative from the point of view of the Optimists?

Mr. Parent: It is extremely conservative. Even in small clubs with 30 or 35 members they raise and spend $12,000, $15,000 a year.

Mr. Flummerfelt: That is approximately $400 a person.

Senator Connolly (Ottawa West): I think you have made a fine contribution to our proceedings. You have also focused our attention upon the community service provided by the service clubs in large and small centres across the country, your estimate of the man hours, of the company time, of the amount that you collect through special projects like the sale of special articles. Perhaps I should not use this word, bingos and other activities provide you with funds to carry out this social service work you do. We commend you for it.

I take it that so far as the White Paper is concerned—and you correct me if I am wrong—your one point is that if the charges which are paid by members for annual dues and for the periodic meal meetings they attend become non-deductible, then all the work that you do in these other categories is in peril, and what you say to the Government is, "Please continue to allow those payments to be deducted"?

Mr. Flummerfelt: This is correct.

Senator Connolly (Ottawa West): Is this the nub?

Mr. Parent: It is very well put.

Senator Connolly (Ottawa West): This is the whole point, and your brief points out the value of the work you do in terms of dollars and cents, manpower, people, area and number of clubs. You are speaking for the service clubs in Canada and you say, "Please don't remove the deductibility of our annual dues, which include the cost of the rental of a place to meet and the meal we have at our periodic meetings"? Is this the substance of it?

Mr. Flummerfelt: This is the substance of it, but we also point out that while we indicated a potential initial revenue to the Government of $4,787,000...

The Acting Chairman: On page 4.

Mr. Flummerfelt: Yes, on page 4—should the membership drop, there obviously would be not an improvement of position because we would have a much lower number of people participating in our service clubs, and the amount might be down to $2 million, so far as the Government is concerned, with the costs to the Government going up, on the other hand, at least 20 times the rate.

Senator Benidickson: To pay for some of the services you perform voluntarily?

Mr. Flummerfelt: Yes.

Senator Connolly (Ottawa West): It is going to cost the Government $4 million...

Mr. Flummerfelt: Initially.

Senator Connolly (Ottawa West): Well, say based on today's figures, it is going to cost the Government $4 million to allow you to continue this work that involves so much free time given by individuals, by people who work in companies, with the permission of the corporate authorities, to do the kind of social service work that you do?

Mr. Flummerfelt: Yes.

There is another important factor here. Any man who is an employer here knows that when people become emotionally dead in their operations they are hard people to motivate in their businesses. They also know that there is a 30 to 40 per cent greater potential productivity that lies within every one of the employees within that group. The extraordinary thing that we found in Expo was that not only did the service clubs do the greatest job ever in history, but the productivity of the men within their own organization was sustained right through the whole picture.

The Acting Chairman: What you are saying is that the company benefits through greater productivity, and also the individual members are better citizens.

Mr. Flummerfelt: I am, indeed. I am also saying, in reverse, that to take this kind of thing out of the Canadian pattern and cause the individual to develop an attitude supported by a company which also has this attitude that it is not its responsibility to look after the social, cultural, and so on fields, then you have a group of people who tend to be strictly introverted, isolationist, selfish in their concept, and it changes the concept of what we as Canadians have made our Canadian way of thinking, and we become kind of an emotionally dead group of people who have not the same kind of drive that has made this country what it is. So help me!

Senator Desruisseaux: This appears to be well indicated in the general conclusions, and if those conclusions could be read they could form a very substantial part of what is being said now. Possibly there are two or three other points they have to add.

The Acting Chairman: I think that Senator Desruisseaux feels it would be desirable if you go to page 7 of your brief and read it into the record.

Senator Connolly (Ottawa West): Can we take it as read?

The Acting Chairman: Very well, we can take it as read and have it incorporated in the record.

(*Text follows*)

General Conclusions

A small increase in tax revenue may result in the short run if there is a restriction regarding the tax deductibility of service club dues and luncheon expenses.

This increase may be expected to decline sharply if service club membership drop sharply.

This temporary financial advantage of a nominal sum proportionately is offset by:

Fewer persons to give free time to voluntary activities in the public service field.

Fewer money-raising activities on a voluntary basis, for smaller financial targets.

Greater dependence on government expenditure to provide replacement services in the areas of youth development, public educatcon, social welfare, cultural activities, hospitals, homes for the aged, etc.

Less citizenship responsibility is likely to come from corporations.

Most important of all, fewer Canadians will be participating of their own free will to help bridge the gap between the new needs of our society in each community and the support that may be expected from our governments when these needs have matured to become political issues.

Regional and local needs will be much less flexibly resolved because of the rigidity of red tape—government representation—departmental budgetary limitations, and lack of voluntary community support.

This means the erosion of a basic tradition in the Canaduan way of life, on a participatory basis.

The Kiwanis Club of Montreal and all clubs endorsing this submission are in support of the government's objective to create an equitable taxation system in Canada.

We respectfully ask, however, "Does it make good sense to raise $5,000,000 a year by denying deductibility of service club dues and luncheons if this action could lead to a realistic cost of $30,000,000 a year in the short run and as much as $100,000,000 to $200,000,000 a year if service clubs cease to exist in 10 years' time?"

Senator Beaubien: Mr. Chairman, on page 5, paragraph (c)(ii) 135,000 people giving $80 each, did they get a charitable receipt for that?

Mr. Flummerfelt: No, that is funds raised. For instance, a person sells maple syrup and the profits from the maple syrup that man sells...

Senator Beaubien: There si no receipt given?

Mr. Flummerfelt: No receipts whatever.

Mr. Parent: If you sell a $1 ticket or a $5 ticket, you do not get a receipt for that.

Senator Beaubien: You can sell a great number of tickets.

Mr. Parent: I know, but most funds are raised with little gimmicks like this.

Senator Carter: I understood the witness to say that this is a rough figure, but you are in

the process of getting a more accurate figure of what the capital raised is.

Mr. Flummerfelt: It will be our object to make a request through the various national organizations to provide a central information pattern that we can then provide to the House and the Senate for next year, but it will not be possible this year.

Senator Carter: But we will have it in due course?

Mr. Flummerfelt: It is our hope to get this co-operation.

The Acting Chairman: Are there any other of your colleagues who would like to add anything?

Mr. Twizell: It bothers me a lot that we are talking so much about money here, and I want to be sure it is not conveyed to people here that the service clubs collect money and give it out in charity. There is a much bigger job than this being done, and I want to mention two or three things the Montreal club, of which I am past president, has done.

First of all, anyone who has been in Montreal must have seen the ambulance system that we have there. It is the best anywhere. The police have ambulances and in most cases they get to the scene of an accident within five minutes. The Montreal club worked four years on a special committee to get that. It is being copied all over this continent, it is so good. If this is the only thing the Montreal club has ever done, it is worth while. There is no money involved here at all.

The second thing is that six years ago the Montreal club got the community stirred up about water pollution. A year after that we worked on air pollution. These things have involved no money. They are busy now, and have been busy for four years, trying to set up a centre for the development of human resources. There is nothing like it anywhere. Again, there has been about $2,000 spent. This would be a tremendous thing if we were able to organize it. It is the thinking of the business community we are able to develop, and I would hate to leave here with members thinking that all we did was collect a relatively few dollars and then donate Christmas baskets and this kind of thing. This is not what we are doing now. We are thinking of what is good for the community. If it costs some money, we try to raise this money, but the big thing we are proud of is that we are trying to do the thinking for the community, which is so necessary today.

Senator Connolly (Ottawa West): This is a good statement to have on the record.

The Acting Chairman: I think, in further answer to what Senator Connolly has said, the reason why we are emphasizing the money aspect is because this committee is sitting to deal with the subject matter of money and proposed taxation under the White Paper. If we have emphasized that part, it is not because we are underestimating the importance of the work being done by the service clubs. On the contrary, we are taking that for granted, but we are trying to justify a possible recommendation that if we are asking the Crown to forego $4,700,000 in the form of club dues that bring people together that we want...

Mr. Twizell: I think it should be understood that you would not lose this $4 million. As an estimate I would think that if the fees are taxable we would lose about 25 per cent of our members. I am talking of Montreal. Most of this is paid by the companies. If it was not taxed I think they would take some of the members away and we would lose about 25 per cent of our members.

Senator Connolly (Ottawa West): Does not the White Paper recognize the fact that you can charge club fees and entertainment to the extent of $150 a year? Your members probably would have activities that would eat that up, and therefore the monetary requirements to join your club or to remain members in your club—the availability of money—would be impaired.

The Acting Chairman: Are there any further questions? Gentlemen, you have come a distance. Would any of you like to supplement with any further remarks?

Mr. Benjamin: Perhaps I could say that the Inter-Service Club Council was formed prior to Expo. The City of Montreal was interested in having the service clubs work with them on Expo. We approached each other and eventually eight of the leading service clubs in Montreal got together. Our first project was to sell $2 million worth of Expo passports for the city, and I would say the share going directly to the service clubs was approximately $300,000, which was used for community work.

In the planning with the city it was definitely understood that the proceeds were to

be used for community work, and this community work was to bring indigent children to Expo. We did not know how large this project would be, but well over 70,000 indigent children were brought to Expo at no cost once they reached Montreal.

We like this idea of having eight orders and then an additional one joining us. We found that the nine orders in communities could do a much larger job than any one service club or any one service order. We tried and did accomplish a few projects.

We had a seminar of Canadian youth which was successful. We worked with the Social Welfare Court of Montreal and we lent our services where no other service club has entered. We would say that we would do what has to be done as long as it can be done. We feel that the grouping together of nine service orders served as a sort of communication centre. It has been a wonderful thing and we would like to continue it. We see this as a way that service work can be done on a more efficient scale than ever before.

Senator Connolly (Ottawa West): I have one more question. If $150 is too low a ceiling, have you any idea how high a ceiling you could live with?

Mr. Benjamin: The reason for the hesitation in answering is that there are nine different orders. Some of these orders have luncheon meetings, and I would say that a $220 minimum would be closer. Other clubs have supper meetings, which might end up at $150. There are some orders which do not have meetings with meals; they generally only have refreshments. Their expenses may be $80 or $90. Overall, the average of $150 and the range of $80 to $225 would be a better figure.

Senator Connolly (Ottawa West): You are not in the category that the proposals in the White Paper are designed to get at, namely, the people who are trying to live on expense accounts. It is quite obvious, Mr. Chairman, that is the situation, but in getting at the people who are trying to live on expense accounts these people here today may be adversely affected.

The Acting Chairman: That is really the issue.

Mr. Twizell: On the question of cost, the Montreal Rotary Club has 30 committees. Some of our members are on as many as five committees. I am on five. I not only attend the regular Tuesday meeting, but I attend at least two other meetings a week, sometimes three.

Senator Connolly (Ottawa West): You are as badly off as we are.

Mr. Twizell: I am saying that $150 does not cover my expenses.

The Acting Chairman: If there are no further questions, do I have a motion to adjourn?

The committee adjourned.

APPENDIX A

COMMENTS
ON THE
PROPOSALS FOR TAX REFORM

MASSEY-FERGUSON LIMITED

Massey-Ferguson Limited
TORONTO CANADA

INDEX

SUMMARY

We are in basic agreement with the four main objectives underlying the White Paper's proposals on taxation of international income, particularly foreign investment income of Canadians:

1. The Canadian tax system should neither encourage nor discourage the use of domestic capital for investment abroad (para. 6.8).

2. Canadian companies should be allowed to compete on the international scene without being subject to more onerous taxes than their foreign competitors (para. 6.9).

3. It is in Canada's interest to maintain an international climate hospitable to the unrestricted flow of capital across international boundaries (para. 6.9).

4. Canadian tax laws on foreign income should not permit Canadian taxpayers to avoid Canadian tax by artificial arrangements (paras. 1.47-48 and 6.4).

We feel that there are several aspects of the proposals that conflict with one or more of the objectives, and may have other undesirable consequences. These aspects, which are summarized below, with references to the detailed analysis in the attached chapters,* would have a direct impact on Massey-Ferguson but we believe they have far more important implications for Canada's economic growth and foreign relations.

1. Some aspects of the proposal to integrate corporate and personal tax, and the taxation of foreign dividend income would discourage Canadians from investing abroad (II. 3, IV. 3, IV. 4), with serious implications for exports and for Canadian companies restricted in their growth by the size limitations of the Canadian market.

2. The proposals to integrate personal and corporate tax encourage foreign control of Canadian companies with foreign subsidiaries (IV. 5, IV. 7, V. 3). Canadian-owned companies with foreign subsidiaries would be threatened with difficulties in raising Canadian equity capital and Canadian shareholders would be encouraged to sell out to foreign shareholders.

3. The desire to eliminate fraudulent avoidance of Canadian tax has resulted in "shotgun" provisions with serious implications for Canada's foreign relations (II. 4) and the administrability of the Canadian tax system (III. 2). Adoption of these provisions would subject Canadian companies to more onerous taxes than their competitors (II. 5, III. 2, III. 4).

* References are to chapter paragraphs.

4. Canada's foreign relations in general and the tax treaty negotiations in particular would be seriously complicated by the proposals' disregard of international taxation trends (II. 2, VI.1, VI. 2, VII. 2), the proposal to integrate corporate and personal tax (V. 3), and the attitude towards developing countries (II. 3, II. 4, VI. 1, VI. 3)

5. The proposals conflict with the policy of other Canadian Government departments that have promoted foreign investment by Canadians (I. 4, II. 3, II. 4) and Canadian participation in the industrial development of developing countries (II. 4).

6. The proposal to integrate corporate and personal tax has serious implications for the use of the tax system as an economic instrument, particularly in Federal-Provincial relations (V. 2) and may have an undesirable impact on Canada-U. S. relations, and result in very significant revenue loss for the Canadian treasury (V. 3).

7. Canada's ability to compete with the United States for urgently needed qualified managerial, technical and professional talent would be further impaired (VII. 1), and the free movement of personnel in and out of Canada would be seriously curtailed (VII. 2). The negative impact on the availability of qualified Canadian personnel could impair Canada's utilization of its resources and capital.

8. The White Paper's preoccupation with foreign ownership of Canadian assets has prevented adequate recognition of the political and economic benefits for Canada of Canadian investment abroad, particularly with regard to balance of payments and export of manufactured goods as is illustrated by Massey-Ferguson (I. 1, I. 2, I. 4).

We believe that the development of Canadian companies with foreign subsidiaries would be severely restricted if not aborted by the aforementioned aspects of the White Paper proposals. We have therefore developed several modifications to the White Paper proposals which would remove the undesirable consequences mentioned above. With one exception (V. 9), the proposed modifications are small and would have no or only minimal revenue impact. The most important of these modifications are:

1. Canadian shareholders should be allowed a credit for underlying foreign corporate tax as well as Canadian tax (IV. 8).

2. The tax exemption for dividends of foreign subsidiaries should not be restricted to subsidiaries in treaty countries (II. 8).

3. The "passive income" proposals should be specially tailored to prevent Canadian tax avoidance (III. 5).

I. MASSEY-FERGUSON

SUMMARY

The development of Canadian companies with foreign subsidiaries is important for the continued economic growth of Canada.

The case of Massey-Ferguson illustrates how Canadian companies go abroad to overcome the size limitations of the Canadian market, and the benefits of such foreign operations to Canada. Quite often foreign investments and the resulting benefits can be achieved with only small investment of Canadian capital.

The Department of Industry, Trade and Commerce, the Department of External Affairs and, more recently, the Canadian International Development Agency have encouraged Canadian companies to "go international."

Adoption of the White Paper proposals without the modifications proposed in the other chapters of this brief would have seriously damaging effects on the competitiveness of Canadian companies in foreign markets and could conceivably lead to foreign ownership of Canadian companies with foreign subsidiaries.

1. ESTABLISHING FOREIGN OPERATIONS

The White Paper recognizes (para. 6.9) that Canadian companies often find it necessary to establish marketing and other operations abroad to escape the limitations of the relatively small size of the Canadian market.

The history of Massey-Ferguson illustrates the relevancy of this observation. The company is the free world's largest manufacturer of tractors, combine harvesters and diesel engines, with 42 factories in 14 countries and sales that exceeded one billion dollars in 1969.

It is obvious that the Canadian market for agricultural and construction machinery and diesel engines could not support a company even a fraction of the size of Massey-Ferguson.

2. CANADIAN ECONOMIC ASPECTS

The activity of Canadian companies in foreign markets is of considerable benefit to Canada, as illustrated by Massey-Ferguson. Some of these benefits are intangible, such as the prestige and goodwill for Canada generated by employees and products overseas. Massey-Ferguson's leadership in many aspects of world agri-business is generally acknowledged.

Another intangible benefit is that Massey-Ferguson, in part by bringing into Canada experienced managerial, professional and technical talent from many other countries, has contributed significantly to the training of Canadians and the development of technology in Canada. Canadian customers and industry have also benefitted from Massey-Ferguson's product development and research conducted throughout its worldwide operations.

A major contribution Massey-Ferguson has made to Canada's economy has been the distribution to thousands of Canadian shareholders of earnings largely accrued abroad. During the 5 years from 1965 to 1969 alone, Massey-Ferguson repatriated in excess of \$70,000,000 of dividends from its foreign operations of which over \$43,000,000 were distributed to Canadian shareholders.

The advantages to the Canadian economy of investment abroad by Canadian companies are not properly recognized in the White Paper. By careful use of foreign borrowing leverage, a small equity investment can often be sufficient for substantial business activity and consequently result in quick "payback" of the original investment. Subsequent repatriation of earnings and continued exports are beneficial to the Canadian balance of payments and the economy in general without offsetting disadvantages. Also, investment abroad by Canadian companies and Canadian control of foreign subsidiaries is in Canada's interest, particularly with regard to the promotion of manufacturing and processing industry in Canada, rather than restricting Canada's role to exporting of raw materials.

The growth of Massey-Ferguson's Canadian operations is directly connected with the development of its foreign operations. By the establishment of subsidiaries abroad, Massey-Ferguson has gained a foothold in many foreign markets. Also, the broad range and large volume of Massey-Ferguson products has made possible the development of an integrated production system. As a result, components and products manufactured in Canada are ultimately sold in a variety of other countries, a contribution to Canada's exports of $540,000,000 in the last 5 years.

3. CANADIAN TAXES AND INVESTMENT ABROAD

The growth of Canadian companies with foreign subsidiaries would be made very difficult if the Canadian tax system would discourage Canadians from investing abroad and subject Canadian companies active in foreign markets to more onerous taxes than their competitors. These two objectives are recognized as fundamental to the White Paper proposals. However, several aspects of the proposals are likely to produce contrary results, as explained in more detail in the following chapters.

4. OTHER GOVERNMENT DEPARTMENTS

Canada's post-war commercial policy has been to promote active participation by Canadians in world trade. This is, for example, reflected in the activities of Canada's Trade Commissioners and financial specialists abroad, and particularly in the recent enactment of the Export Development Act which encourages foreign investment

by Canadians. In commenting on the reasons for establishing the Export Development Corporation, the Minister of Industry, Trade and Commerce on November 3, 1969 emphasized the vital importance to Canada of international trade and the growing importance of competitive financing ability in world trade, particularly because Canada is comparatively more dependent on international trade than its competitors.

II. DIVIDENDS FROM FOREIGN SUBSIDIARIES

SUMMARY

The proposal to continue in principle the existing tax exemption of dividends received by a Canadian company from a foreign subsidiary is suitable to the end in view, i. e.

- Neither to encourage nor discourage Canadian investment abroad
- Maintaining Canadian competitiveness in foreign markets.

The proposal to restrict this exemption to subsidiaries in countries that have a tax treaty with Canada should not be adopted:

- It would result in artificial and arbitrary discrimination against Canadian investors in many countries, particularly developing countries.

- It could jeopardize Canada's relationship with developing countries, conflicting with the foreign policy of Canada.

- It subjects Canadian companies in many foreign countries to substantially heavier taxes than their competitors.

- The "passive income" proposals, modified as suggested in Chapter III would be sufficient to prevent artificial Canadian tax avoidance, and the distinction between subsidiaries in treaty countries and non-treaty countries would not be required for this reason.

1. THE TAX EXEMPTION OF DIVIDENDS FROM FOREIGN SUBSIDIARIES

The White Paper proposes to continue in principle the present exemption of dividends received by Canadian corporations from foreign subsidiaries. We agree that this is the best method of achieving the first two objectives stated in the White Paper, i.e., tax neutrality vs. Canadian investment abroad and not jeopardizing Canadian competitiveness in foreign markets.

The exemption can be qualified in a simple manner to meet the requirement of preventing fraudulent Canadian tax avoidance as outlined in chapter III.

Although the exemption is conceptually at odds with the proposed system to integrate corporate and personal tax, this should not present a significant problem if the proposal outlined in Chapter IV is adopted. Certainly, the exemption is preferable by far to the incredibly complex and potentially harsh and inadequate proposals put forward in this regard by the Carter Commission. It is also better than the often arbitrary and complicated approach taken by some other countries. In our brief to the Government concerning the Carter Commission proposals, and on several other occasions, we have advanced compelling arguments for the superiority of the dividend exemption system. We would be pleased to discuss these with the Committee if it so desires. For the purposes of this brief, however, it may be sufficient to indicate that the White Paper proposal, in our opinion, is logical and sound.

2. NEGOTIATING TAX TREATIES

The imposition of different tax regimes on the income of foreign subsidiaries depending on whether their country of residence has concluded a treaty with Canada would attach great importance to Canada's negotiation of tax treaties. Even without this, tax treaties are an important factor in the development of trade between countries.

We agree with the observation in para. 6.5 of the White Paper, that it is an unfortunate side effect of tax treaties that they result in discrimination against investment in, and residents of, non-treaty countries. Because we do not share the White Paper's optimism that Canada will conclude a wide

network of treaties in the near future (see below and chapters V. 3, VI. 1 and VI. 2) we suggest that it is not in Canada's interest to adopt tax laws that would magnify this discriminatory aspect of the treaties.

The negotiation of tax treaties is usually a long and complex process. There are several reasons why countries may be unwilling or unable to conclude a treaty with Canada:

- for most developing countries, tax treaties would be lop-sided in the developed country's favour. Eager to attract foreign investment and unable to export capital, developing countries are usually in a position where no offsetting benefit can be obtained against tax concessions demanded from them;

- tax systems of several countries may be irreconcilable with the Canadian system. Each of the two parties would insist on concessions unacceptable to the other;

- countries in the process of reforming their tax system usually suspend all tax treaty negotiations. Canada itself has been in this position for the last 5 years;

- "most-favoured-nation" commitments in many countries may prevent the other country from granting concessions that would be essential to Canada and vice-versa.

We are convinced that Canada cannot expect to conclude meaningful tax treaties in the foreseeable future with most developing countries, a conclusion supported by the almost total absence of tax treaties concluded by the developing countries. (Apart from obvious examples of developed countries having treaties with former colonies, only West Germany has been reasonably successful in tax treaty negotiations with developing countries. It should be recognized, however, that Germany grants unilaterally very significant tax incentives to German taxpayers investing in such countries.)

3. DISCOURAGING CANADIAN INVESTMENT IN DEVELOPING COUNTRIES

In their eagerness to attract foreign investment, many developing and several developed countries offer powerful tax incentives: low tax rates, tax holidays and exemptions for companies and personnel, attractive depreciation or depletion

allowances, etc. In addition, regular corporate tax rates in most developing countries are already low compared with developed countries. It should be recognized that these tax incentives are often the only meaningful way for such countries to offset the natural hesitations of foreign investors arising from the political, monetary, geographic, climatic, economic, social and personnel problems generally associated with investment in these countries. In the few recent treaties that have been concluded by developing countries, the developed country partner usually has undertaken not to impose domestic taxes that would eliminate tax advantages given by the developing country.

Under the White Paper proposals, the advantage of these tax incentives would be all but eliminated for Canadian investors, as the earnings of subsidiaries in these countries would be subject to full Canadian tax rates. This is contrary to the purpose of the recently enacted Section 34 of the Export Development Act which attempts to assist Canadian industry in developing countries by providing a guarantee against political and other risks.

We are convinced that the result of this aspect of the White Paper would be that Canadian companies would reduce their investment activities in developing countries.

4. REPERCUSSIONS ON CANADA'S FOREIGN POLICY

Private Canadian investment in developing countries has been an effective way to build up Canadian goodwill in our relations with developing countries. It is an important aspect of Canada's policy to assist the industrial development of developing countries. For example, in a speech as recent as November 3, 1969, the Secretary of State for External Affairs re-emphasized the significance for Canada of aid and development problems in the world today.

The governments of developing countries would certainly resent the White Paper's discouragement of Canadian investment in their countries, and this could have serious implications for Canada's foreign policy and export trade.

5. REPERCUSSIONS ON CANADIAN COMPETITIVENESS

The proposal is also diametrically opposed to the second objective as it puts more onerous taxes on Canadian operations in non-treaty countries than is suffered by their local and international competitors, dealing a harsh blow to Canadian competitiveness abroad.

6. DISCOURAGING REPATRIATION OF DIVIDENDS

If the proposal were adopted, Canadian companies would be strongly motivated to defer Canadian taxes by not repatriating to Canada dividends earned in non-treaty countries. This would have longer-term implications for the Canadian balance of payments.

7. TAX AVOIDANCE CONSIDERATIONS

The purpose of the restriction of the dividend tax exemption to subsidiaries in treaty countries is to prevent artificial reduction of Canadian tax by tax-haven arrangements. We feel that tax-haven abuse always takes the form of "passive income" transactions. The proposals of the White Paper with regard to passive income are reviewed in chapter III. If they should be modified along the lines suggested in that chapter, the distinction between subsidiaries in treaty and non-treaty countries would tend to be superfluous.

8. CONCLUSION AND RECOMMENDATIONS

The proposed distinction between dividends from foreign subsidiaries in treaty vs. non-treaty countries is undesirable because of its implications for Canada's foreign relations and Canadian competitiveness in foreign markets. We recommend that dividend exemption should be extended to non-treaty as well as treaty countries and that the problem of tax avoidance be resolved by adopting "passive income" rules as set out in chapter III of this brief.

III. "PASSIVE INCOME"

SUMMARY

The lack of detail in the proposals to introduce provisions patterned "generally" on those in the United States (known as "Subpart F") creates a problem for Canadian companies to respond adequately to the Government's invitation to discuss the White Paper proposals. However, some comments of a more general nature may be made.

Adoption of provisions along the lines of Subpart F in all its massive complexity would result in administrative and compliance problems unsuitable for Canada and not justified by the nominal revenue gain. On the other hand, adoption of a "simplified" Subpart F would almost certainly put Canadian companies operating in foreign markets at a severe competitive disadvantage.

Subpart F does not fit into the existing or proposed Canadian tax system.

As the provisions contain a "shotgun" approach, they would result in serious "overkill" in penalizing bonafide efforts of Canadian companies to reduce the foreign tax burden which do not reduce Canadian tax in any way. In fact, as such savings of foreign taxes result in higher income to the Canadian shareholder, they increase Canadian tax revenue. This approach of the White Paper proposal has serious implications for the competitiveness of Canadian companies operating in foreign markets.

We suggest that the proposal be modified to deal specifically with artificial avoidance of Canadian tax. This would achieve the White Paper's objective without the undesirable consequences outlined above.

1. THE UNITED STATES "PASSIVE INCOME" PROVISIONS

The U.S. system referred to in the White Paper is generally known as the "Subpart F" provisions. Subpart F was introduced in 1962 and presents one of the most complex and least understood areas of the U.S. Internal Revenue Code. Broadly speaking, it designates certain kinds of income of foreign subsidiaries as Subpart F income, taxable in the hands of the U.S. shareholder as and when accrued in the subsidiary. Subpart F income consists of three types of income, derived by a foreign subsidiary from activities or investments outside its country of incorporation (foreign base company income). These three types are:

- Investment income: dividends, interest, royalties and capital gains;
- Service income: service fees and commissions;
- Trans-shipment income: income from re-selling in third countries, goods purchased from affiliates, or vice versa.

The main thrust of this legislation was aimed at U.S. firms which accumulated low-taxed income in tax-haven subsidiaries, thus indefinitely deferring U.S. taxes and contributing to the balance of payments problems of the U.S. However, both the Administration and Congress recognized that the legislation, without appropriate reliefs, would impose a very heavy penalty on U.S. companies competing abroad with corporations from other countries where such tax-saving and tax-deferral techniques are permitted and sometimes encouraged. Subpart F was therefore enacted with a string of qualifications, exceptions and exemptions that would allow U.S. companies with bonafide activities abroad to escape the competitive damage threatened by the Subpart F provisions.

The outcome of all this has been two-fold:

- The legislation has become incredibly complex and the administration of it continues to pose such problems to the Internal Revenue Service and tax practitioners that an overall review is being considered.

- Subpart F has been largely ineffective. Expert tax planners have been able to use the exceptions installed to prevent competitive damage to bonafide U.S. companies operating abroad as "loop-holes" for less bonafide efforts.

2. IMPLICATIONS FOR CANADA

We suggest that it would be a mistake for Canada to introduce legislation modeled after a system that has proven ineffective and unadministrable, even for the largest and most expensive and sophisticated tax administration in the world. Recently, the U.S. Government has indicated that in the overall review of tax rules relating to international income which is currently being conducted, significant amendments will be made to the Subpart F provisions.

If on the other hand the Canadian version of Subpart F would eliminate the complex reliefs and exemptions that present the most difficulties in Subpart F, serious competitive damage would be inflicted on Canadian companies with bonafide foreign operations.

3. CONFLICT WITH OTHER WHITE PAPER PROPOSALS

The Subpart F approach does not fit at all in the other White Paper international tax proposals. To the extent that passive income of the foreign subsidiary is derived from affiliates in countries other than Canada, particularly treaty countries, such income would, without the foreign subsidiary, never have been subject to tax in Canada. There is no justification whatsoever for making such income taxable in Canada, as there is no avoidance of Canadian tax involved. A few examples will illustrate this:

(a) A foreign subsidiary investment company holds the shares of subsidiaries in the U.S., U.K., France and other countries that have a treaty with Canada. The benefit derived from this arrangement is to take advantage of withholding tax rates on dividends provided in many treaties, that are lower than the 15% maintained in practically all the Canadian treaties. (For example, the U.S. levies only 5% on dividends to parent companies in 17 countries other than Canada.) Accumulation of such dividend income in the foreign holding company reduces or defers foreign dividend withholding taxes, and no reduction or deferral of Canadian taxes is attempted or achieved.

(b) A foreign patent holding subsidiary builds up an inventory of patents from non-Canadian investors and grants licences to non-Canadian affiliates. Royalty income that would otherwise have accrued in high tax areas can thus be accumulated with only small tax expense. If the patent holding company had not existed, the royalty income would have accrued abroad, and after payment of foreign tax, be remitted to Canada as a tax-free dividend. Again, the operation of this type of foreign subsidiary does not attempt or achieve reduction or deferral of Canadian tax at all, and there is no justification for Canada's subjecting its income to tax.

(c) A trading subsidiary established abroad buys from outsiders and sells to non-Canadian affiliates or vice versa. The profit from these trans-shipments would without a trading company have accrued in the other affiliates and again would have been tax-free when remitted to Canada as dividends. There is no Canadian tax revenue impact from the trading company's operations.

(d) A finance subsidiary borrows funds abroad for use in a third country. No Canadian taxpayers are involved on either the borrowing or the lending side, and no reduction of Canadian tax is involved.

In all these or similar cases, adoption of the White Paper proposals would not result in any additional Canadian tax revenue, since the Canadian parent would probably cause its subsidiary to discontinue operations and pay the foreign tax which is usually lower than the Canadian tax. It would result in higher foreign taxes paid by the foreign subsidiaries of Canadian companies. The effect of this would be that Canada would legislate into effect revenue increases for foreign governments, and a reduction in Canadian tax revenue since the higher foreign tax results in lower taxable income for the Canadian shareholder. There is a great difference with the U.S. system in this respect; the U.S. taxes dividends received by U.S. corporations from foreign subsidiaries, and use of tax-sheltered passive income subsidiaries therefore results in reduction or deferral of U.S. taxes. This is not true for Canada, either under the present or the proposed system, and this difference makes it impossible to reconcile the U.S. Subpart F provisions with the Canadian present or proposed system.

4. REPERCUSSIONS ON CANADIAN COMPETITIVENESS

The practical consequences of the White Paper proposals would be very serious. Most countries allow their taxpayers with bonafide foreign operations to arrange their affairs in a manner that reduces the foreign tax burden (because of the wide range of exceptions embodied in Subpart F, the U. S. is included in this group.) Consequently, all international companies, no matter where their base, make frequent use of passive income tax-haven subsidiaries. If the White Paper proposals are adopted, Canadian companies active in foreign markets would therefore be at a severe competitive disadvantage. The second objective of the White Paper, i. e. that Canadian companies should not be subject to more onerous taxes than their competitors, would be largely if not completely frustrated.

5. CONCLUSION AND RECOMMENDATIONS

Adoption of the U. S. provisions would be undesirable. The estimated $10 million annual revenue loss due to tax-haven abuses can be recovered in a much simpler and more equitable manner as described below. In view of this, the administrative complexity and competitive damage connected with Subpart F are clearly inappropriate. The authors of the White Paper, in their eagerness to prevent Canadian tax evasion, have chosen a method that would thwart achievement of the two primary objectives which, in our opinion, is essential to the continued existence and development of Canadian companies in international markets.

We feel that there are equally effective and substantially more equitable alternative methods to achieve the objective of preventing Canadian tax evasion, and we urge that the following be given serious consideration.

The present Canadian tax laws include several provisions, that if strictly policed, could eliminate practically all Canadian abuse of tax-havens. In particular, the law on management and control, and Sections 17, 137 and 138 of the Income Tax Act are potentially powerful weapons when applied by a determined tax auditor. The Internal Revenue Service of the United States has been more successful in their fight against tax evasion by using the arms' length standard and the "sham" approach than in the Subpart F legislation. However, if the Department of National Revenue.

feels that more specific rules are required to aid them in the battle against tax evasion, we suggest that the following alternative be adopted:

> The Canadian shareholder of a passive income foreign subsidiary would be required to submit annually to the Canadian revenue authorities complete financial information for their examination. Upon such examination, the Government would have no problem in determining to what extent the subsidiary had obtained passive income from Canadian sources. The transactions between the foreign subsidiary and Canadian affiliates could be investigated in depth and if necessary, adjusted to satisfy the arms' length standard. Also, the Canadian authorities would be able to determine very simply to what extent income has been diverted, that would otherwise have accrued in Canada and been subject to tax in Canada. If there is such income, the Canadian taxpayer would have to rebut a presumption of artificial Canadian tax avoidance.

The rule could be summarized as follows: Where a passive income subsidiary of a Canadian taxpayer or taxpayers exists,the income of this subsidiary would be treated as if it had been received by the Canadian taxpayer directly - with a credit for income taxes and withholding taxes paid - to the extent such income would, without the existence of the subsidiary,have accrued directly to the Canadian taxpayer(s), and to the extent that it cannot be justified by the commercial activities of the subsidiary.

This alternative, in our opinion, would achieve the objective sought by the government without raising the problems connected with the "treaty vs. non-treaty" proposal, without the excessive complications inherent in Subpart F, and without the severe competitive injury to bonafide international efforts by Canadian companies inherent in both.

IV. FOREIGN TAXES AND THE SHAREHOLDER - A "COUNTRY OF SUBSIDIARIES"

SUMMARY

The White Paper proposes to replace the existing dividend tax credit system by a system of full or partial integration, whereby the shareholder's dividend tax credit is calculated on the basis of tax paid by the corporation.

We have in Chapter V submitted strong theoretical and practical objections to the system of integration. However, in this chapter we concentrate on one particularly damaging aspect of the integration proposal.

The White Paper proposals would restrict the Canadian shareholder's dividend tax credit by only allowing Canadian taxes paid and up to 15 per cent foreign dividend withholding tax as a credit to the shareholder. This restriction is inconsistent with the concept of integration and could have very serious consequences:

- discrimination against Canadian shareholders of Canadian companies with foreign operations;
- discouragement to Canadians to invest abroad;
- discouragement of exports;
- encouragement of foreign ownership of those companies with substantial operations abroad, thus making Canada a country of subsidiaries.

We recommend that a minor amendment to the integration proposal be made to remove these inequities. The cost of such amendment would be nominal compared with the estimated $140 - $230 million revenue loss caused by integration.

1. ONLY CANADIAN TAX IS CREDITABLE TAX

The proposed system of integrating personal and corporate tax is based on the concept of double taxation, i.e., that the income realized by a corporation should not be taxed twice - first in the corporation and later as a tax on the dividend received by the shareholder. This theory can be seriously challenged, and integration raises many practical problems which are dealt with in chapter V.

The White Paper proposes to recognize as creditable tax to the shareholder, only Canadian taxes and up to 15 per cent foreign dividend withholding tax paid by the Canadian company distributing the dividend. The effect of this restriction is that the Canadian shareholder is taxed twice on profits earned abroad, which cannot be reconciled with the integration concept. To allow double taxation relief to some shareholders and not to others depending on where the tax is paid is an arbitrary and inequitable manner of dealing with what was recognized by the Royal Commission on Taxation as one of the most complex problems that integration raises in the international tax environment.

2. DISCRIMINATING AGAINST CANADIAN SHAREHOLDERS

The effect of the restriction mentioned above on a Canadian shareholder of a widely held Canadian company* with a subsidiary in the U.S.A. is shown below:

	Present System		Proposed System	
	Earned in Canada	Earned in U.S.	Earned in Canada	Earned in U.S.
Pre-tax profit	$ 200	$ 200	$ 200	$ 200
Corporate tax	(100)	(100)	(100)	(100)
Dividend withholding tax in U.S.	-	(15)	-	(15)
Net Available Common	100	85	100	85
Shareholder's grossed-up taxable dividend	100	85	150	100
** Tax (50 per cent marginal rate assumed)	(50)	(42.5)	(75)	(50)
Tax credit	20	17	50	15
Net tax	(30)	(25.5)	(25)	(35)
After tax yield	$ 70	$ 59.5	$ 75	$ 50

Notes:

* While the example deals with a widely held company, the comparison becomes even more acute for a closely held company, because in such case, the after-tax yield to the shareholder on profits generated in the U.S. is 50 per cent less than that on Canadian profits.

** The use of other tax rates would change several amounts in this comparison but the relationship between the bottom line amounts would remain the same.

This simple calculation illustrates clearly the discriminatory effect that the proposal has on a Canadian company with foreign activities. This discrimination directs itself against the Canadian shareholders of such companies who would receive 33 per cent less return on foreign-origin profits than on domestic profits.

3. DISCOURAGING CANADIAN INVESTMENT ABROAD

The White Paper recognizes the discriminatory effect in para. 6.10, commenting that the proposal will introduce a preference for Canadian shareholders to invest in Canadian corporations with Canadian operations, but that "there is a difference between an incentive to investment in Canada and a disincentive to investment abroad." Whatever the academic merits of this observation may be, it is obvious that the proposals amount to a powerful disincentive for Canadian companies to seek abroad the expansion and profits denied them by limitations of the Canadian market. They conflict directly with the objectives not to discourage Canadians from investing abroad and to maintain a climate hospitable to the international flows of capital.

4. REPERCUSSIONS ON EXPORTS

The restriction of the tax credit to Canadian taxes paid is also a direct disincentive for Canadians, particularly closely held companies, wishing to export. It should be recognized that achieving a significant volume of export business is usually conditional upon the establishment of a foreign branch or subsidiary, therefore foreign taxes are paid on at least a portion of export profits. If the Canadian shareholder would get no credit for this tax, the sharply reduced return on export profits may well make export operations uninteresting.

5. ENCOURAGING FOREIGN OWNERSHIP

It can be shown that the proposal encourages foreign control of Canadian companies that have substantial foreign investments. The potential reduction in after-tax dividend yield for the Canadian shareholders in such companies might encourage them to sell their shares and buy equities of companies whose operations are entirely in Canada. Foreign shareholders would, if at all affected, be better off under the White Paper proposals than under the existing system, and the Canadian shareholder would therefore find a ready market abroad for his shares. When combining this effect with the increased difficulty, caused by the same reason, for Canadian companies with foreign subsidiaries to raise equity in Canada, the net result may well be that ownership and control of Canadian companies with foreign subsidiaries would transfer to non-residents.

As has been noted several times earlier, the Canadian market for most products is not large enough to support companies of a size that is optimal and competitive from a supply and production standpoint. To remain competitive with foreign companies, Canadian companies are therefore faced with the choice of being absorbed in foreign controlled corporate groups or establishing their own operations abroad.

The combined effect of the proposed restriction on creditable tax, and the flow-through of foreign tax to foreign shareholders (see below, para. 7) would be to encourage the first alternative, thus making Canada even more a country of subsidiaries.

Moreover, discouraging Canadian ownership of Canadian companies is contrary to the policy of the Canadian government in the past decade and we would hope in the future.

6. DISCOURAGING REPATRIATION OF DIVIDENDS

It would obviously be in the interest of the Canadian shareholder if the Canadian company would distribute to a maximum degree its after-tax Canadian profits, while retaining foreign profits in the foreign subsidiary. This disincentive to repatriate foreign earnings does not seem to be in the interest of Canada because of the longer-term balance of payments implications and the reduction of domestic reinvestment or distribution of foreign earnings.

7. PURPOSE OF THE RESTRICTION

The only reason given for this restriction (para. 4.39) is to avoid net outflow from the Canadian treasury. In this connection we believe that:

a. As explained in chapter V, the real purpose of integration is to provide an incentive for investment in Canadian companies. The corporate tax paid is irrelevant in this respect.

b. Allowing 15 per cent withholding tax as a credit to the shareholder already results in revenue loss, regardless of Canadian tax paid, which is strangely inconsistent. Moreover, insofar as this foreign withholding tax "flows through" to foreign shareholders, it amounts to a reduction of Canadian dividend withholding tax now collected, and in fact increases foreign tax revenues at the expense of the Canadian treasury. We find ourselves at a loss to explain why this particular amendment is proposed, other than as an oblique invitation to foreign residents to establish holding companies in Canada for their foreign investments.

c. To avoid net outflow from the Canadian treasury, relief for foreign taxes could be limited to forgiveness of tax otherwise payable by the shareholder/taxpayer without the possibility of refund. This would be comparable to the existing dividend tax credit system. In addition, credit for foreign taxes would only be available if the Canadian creditable tax has been exhausted.

8. CONCLUSIONS AND RECOMMENDATIONS

We believe that the consequences enumerated above are undesirable for Canada. As concluded in chapter V, we believe that the existing dividend tax credit, perhaps with some modification, would serve the purposes of the White Paper better than integration. However, should integration be adopted, we suggest that it is essential that the shareholder be granted similar relief for foreign taxes as for Canadian taxes paid by the corporation or its subsidiaries.

The credit for foreign taxes paid would be restricted to what it would have been had the tax been paid to Canada; it would only be granted if no more creditable Canadian tax would be

available; and it would be restricted to the marginal rate of the taxpayer so that no refund by the Canadian treasury would result.

We believe that an amendment along these lines would be essential to prevent Canada from becoming what we earlier called a country of subsidiaries.

The reduction of tax revenue resulting from such amendment would be nominal as long as Canada does not export capital on a significant scale. It would certainly not be material in view of the serious consequences threatened by the White Paper proposals, and although we do not have access to data that would enable us to calculate its impact, we are certain that it would be insignificant compared with the estimated \$140 - \$230 million revenue loss due to integration itself.

The proposal not to allow credit for foreign taxes paid has not been raised in any public discussion of which we are aware. However, this should not be regarded as being indicative of lack of importance. It is a highly technical point that does not appeal to the general public.

V. INTEGRATION

SUMMARY

One of the fundamental reform proposals in the White Paper is the proposed integration of personal and corporate tax, i.e. allowing the shareholder on receipt of a dividend, full or partial credit for taxes paid by the corporation.

We believe that the introduction of integration as a basic element in the tax system is inappropriate for Canada. Our objections to integration are:

1. It is based on the outdated theory of double taxation.
2. It would all but preclude use of the income tax system as an instrument of economic policy.
3. It could lead to serious consequences in Canada-U.S. relations.
4. It would divert funds from investment to consumption.
5. It would introduce conflicts of interest in shareholder-management relations.
6. It would introduce a new and substantial burden in accounting, record keeping and tax administration for corporations, shareholders and the government.

We recognize the advantage of integrations, i.e. to stimulate the Canadian investor to invest in Canadian equities.

We conclude that this advantage can be achieved in a much simpler and less controversial way by retaining the existing dividend tax credit, possibly adjusted as to rate and with the possibility of refund to lower income taxpayers. The shortcomings of the existing system listed in the White Paper do not stand close examination.

1. THE OUTDATED THEORY OF DOUBLE TAXATION

Integration is based on the concept that profits from corporate activities are subject to double taxation - first at the corporate level, later as personal tax on the dividend received by the shareholder. This theory appears sound when the profit generated by a corporation is compared with the same profit generated by unincorporated businesses. The concept was widely followed in the years where the business world was made up largely of unincorporated businesses. However, with the emergence of the large public companies now predominant in most markets, a new phenomenon developed. The link between corporation and shareholder became more and more tenuous, corporations became independent legal entities in their own right, and the shareholder's role was reduced to that of a passive investor. Corporations now compete with other domestic and foreign corporations, and with few exceptions the influence of unincorporated businesses in the market place has disappeared.

As a consequence, the corporate tax became a cost factor which the corporation, to preserve the interest of the investor, passed on ("shifted") to the customer, rather than the shareholder.

The question of the true incidence of corporate tax, i.e., whether it is borne by the shareholder or shifted to the customer, has been the subject of many economic studies, one of the more recent and readable of which was embodied in the 1967 report of the Ontario Committee on Taxation (Smith Committee, chapter 27, para. 29-66). The Smith Committee correctly concludes that a clear picture of the incidence of corporate tax is essential to the formulation of a sound and equitable tax system. If corporate tax is shifted to the customer, there is no justification per se for relief to the shareholder.

A strong case can be made that in the truly private company, corporate and personal taxes should be integrated as the shareholders are de facto partners in a partnership, and should be treated as such. In such companies, the shareholders are directly involved in or personally exercise the day-to-day management and decision-making of the company, and they can influence the action of the company to meet their personal after-tax income requirements. However, even this is no longer true for most private companies since in all but a few markets the predominance of public companies has set the commercial pattern within which the private company must operate.

For public companies there is very strong evidence that taxes are shifted almost entirely to the customer. The average shareholder in these companies is far removed from the decision-making process, and is only interested in the net earnings, the dividend yield and the growth potential of his investment. After all, he can readily shift his investment into interest-bearing securities or other assets. The average investor in a public company has neither the desire nor capacity to conduct the business of the corporation as a partnership or in some other unincorporated form. The corporation tax paid is of no interest to him other than as a cost factor reducing earnings and yield. Interestingly enough, this conclusion is borne out in the Smith Committee Report (chapter 5, table 5.6) which shows that corporate income taxes are regressive in the lower income levels, with only small progression at the higher levels.

2. THE TAX SYSTEM MUST REMAIN FLEXIBLE

Integration makes the tax system as a whole very rigid and largely destroys the flexibility of Federal and Provincial governments to use the income tax system to deal with structural, cyclical and, particularly, regional economic problems.

Use of the fiscal system has always been very important to the Federal and Provincial Governments. One of Canada's major objectives in the area of public finances is the redistribution of economic wealth and the stimulation of economic activity in less developed provinces and regions of Canada. To this end, a multitude of tax measures have been used. In particular, we refer to designated area tax exemptions, new mining tax exemptions and capital cost allowance adjustments. In addition, the income tax system is very effective in macro-economic government policy. We refer, for example, to adjustment of corporate and individual tax rates, acceleration of corporation tax payments, small business incentives, research and development allowances, and depletion allowances.

All these measures, particularly adjustments to tax rates, will give rise to serious complications and inequities if an integrated system would be adopted. In fact, these and similar measures would be largely ineffective unless accompanied by extremely complex and often arbitrary and inequitable provisions to ensure that the incentive and disincentive maintains its full impact on the shareholder level. It is highly relevant in this regard that Britain in 1965 decided to abandon a system of integration mainly for this reason.

Because the Government would, by adopting a system of integrating personal and corporate taxes, give up some of the most effective instruments in its arsenal of economic legislation, the Committee should seriously consider rejection of the integration proposal, particularly in view of the current economic uncertainty.

3. THE REACTION OF THE UNITED STATES

We should like to draw attention to the consequences of integration that materialized in the case of France which adopted a system of integration in 1965.

Shortly after the introduction of the new French system, the United States Treasury Department requested France to review the position of U.S. portfolio investors in French companies. As mentioned above, integration is based on the theory of double taxation and the U.S. considered it unfair that its residents should be taxed three times on dividends from French companies, whereas double taxation was partly eliminated for French residents. As a result of this pressure, the France-U.S. tax treaty was amended and the French government will now refund in cash to U.S. resident portfolio shareholders of French companies, 50 percent of the corporate tax paid by the French company on underlying profits. Needless to say, both the U.S. investor and the Internal Revenue Service benefit considerably from this at France's expense. The amendment did not pass unnoticed. West Germany, Switzerland, and the Netherlands have now obtained the same concession from France, and other treaty partners are probably lining up. The French Income Tax Act has consequently been amended to authorize the government to extend this 50 per cent refund to all non-resident portfolio investors.

To justify its action with France, the United States can be expected to insist on Canada granting the same concession if it adopts a system obviously modelled on the French. This would be particularly likely since Canada enjoys special exemptions from the Interest Equalization Tax, while France does not. It would be prudent, before any final decision on integration is made, to have an assurance from the U.S. in this regard, as the Canadian treasury could be seriously depleted if this development materializes. Canadian shares would become very attractive to U.S. investors, and a snowballing effect could result with serious implications for the degree of Canadian ownership of Canadian-based companies.

4. INFLATIONARY EFFECTS

The added attraction of dividends due to integration and the 2-1/2 year proposed time limit on corporate distributions would act as a spur for shareholders to demand maximum dividend payout. As stock dividends would not be an attractive alternative in most cases (because of shareholder cash outflow and dilution of equity) this pressure would result in diversion to consumption of funds available for investment in Canada. We believe that this is undesirable, especially in this time of acute capital shortage.

5. SHAREHOLDER-MANAGEMENT CONFLICTS

Integration may pose an awkward dilemma for the management of corporations in that decisions that are justified from the corporate point of view may not be beneficial to the shareholders. For example, a decision to invest in a mining project and thus take advantage of the maximum depletion allowances may be beneficial to the corporation, but not to the shareholders who would receive less creditable tax with their dividends.

We submit that it would be undesirable for the health of the Canadian economy if the Income Tax Act operates in a manner that creates conflict of interest between management of a company and its shareholders. Management, particularly of public companies should be concerned with maximizing the corporation's growth and earnings, and its decisions should not be made in the context of the personal tax situation of a large body of shareholders.

6. ADMINISTRATIVE AND COMPLIANCE PROBLEMS

Because of the need to trace constantly the underlying corporate tax on all shareholders' dividends, integration would present a very substantial additional administrative burden to the Department of National Revenue, corporations and their shareholders. We envisage at least five, and possibly fifteen, information returns filed by every corporation and every shareholder on every dividend.

7. THE PURPOSE OF INTEGRATION

It is clear that the authors of the White Paper have envisaged major advantages to be derived from the integration other than the more or less academic - and substantially incorrect - argument of eliminating double taxation. The real purpose of integration is stated in paragraphs 1.44 and 4.38: to provide an incentive to Canadians to purchase shares of Canadian corporations, thus offsetting the low yield and high risk elements

associated with equity investment, creating investor interest in Canadian equities in particular and counterbalancing in part the capital gains tax proposal. It is unfortunate that the method chosen is not the best to achieve this objective, as the existing dividend tax credit with minor adjustments could do a better job.

8. THE EXISTING DIVIDEND TAX CREDIT

The White Paper asserts (para. 4.18) that the existing method of corporate taxation and the dividend tax credit have many shortcomings. The first four of these deal solely with the existing low tax rate on the first $35,000 of corporate income. The fifth objection is removed by the ceiling of 50 per cent on personal income tax rates proposed by the White Paper.

The sixth objection is that the "dividend tax credit is of significantly greater value to the high-income taxpayer than it is to the low-income taxpayer." This is not true for the great majority of taxpayers. It would apply only if the marginal tax rate of the taxpayer receiving a dividend is less than 20 per cent, since no refund is given if the dividend tax credit exceeds tax payable. Under the existing rate schedule, the 20 percent marginal rate is reached at taxable incomes of $3,000. We submit there are hardly any taxpayers below this level who receive dividends. For all other taxpayers, the dividend tax credit presents a dollar-for-dollar reduction of tax regardless of income. It is certainly much less discriminatory to the lower-income taxpayer than the increase of personal exemptions proposed elsewhere in the White Paper.

The final objection is that tax credit is granted on any dividend paid by a Canadian company regardless of whether it has paid any tax. We maintain that this is irrelevant. The dividend tax credit is an incentive given to Canadian investors to invest in shares of Canadian companies rather than foreign shares or other Canadian or foreign assets. The payment of tax by the corporation is of no concern to the taxpayer/shareholder as demonstrated earlier.

Also, the proposal to make the dividend tax credit dependent on the tax paid by the corporation discriminates against Canadian companies that because of startup losses, a high depreciation or depletion, or cyclical downturns are not paying enough tax to provide full creditable tax. The existing system does not have this disadvantage.

We urge that the existing dividend tax credit system has worked well, as it has provided a simple, effective and fair incentive for Canadians to invest in Canadian companies.

9. CONCLUSIONS AND RECOMMENDATIONS

We suggest that in view of the problems and arguments outlined above, particularly those mentioned in points 2 and 3, the Committee seriously consider recommending rejection of integration of corporate and personal tax.

The objectives of the White Paper mentioned in point 7 can be achieved in a much simpler, less controversial manner and at much lower administrative cost by retaining the existing dividend tax credit. To counterbalance the capital gains tax proposal, the dividend tax credit should probably be increased and be modified to allow refund to the taxpayer if the credit exceeds tax payable.

Unfortunately the statistics are not available to us that are necessary to determine the appropriate rate of dividend tax credit that would result in the same amount of incentive to the investor in a widely held company as the integration proposal. However, we feel that this could be easily established.

To retain the incentive that the White Paper proposes for the shareholder in a closely held company, integration should be allowed for shareholders in a closely held company on an optional basis by maintaining the partnership option.

VI. OTHER INTERNATIONAL ASPECTS

SUMMARY

The White Paper proposals contravene several internationally recognized principles of taxation, specifically with regard to withholding taxes, capital gains and pensions. In addition, some of the proposals are in conflict with the objective to maintain a climate hospitable to the free flow of capital across international boundaries. Very few shortcomings of the existing tax laws are removed, and many are, in fact, aggravated.

The withholding tax proposals are generally inconsistent with the widely followed OECD model treaty. The continued harsh attitude on interest will prevent relief to the acute capital shortage in Canada.

Some of the international aspects of the capital gains tax proposals could create serious difficulties.

The proposal to restrict the foreign tax credit to 15 per cent is inequitable and discriminatory.

We conclude that these aspects of the White Paper would jeopardize Canada's ability to conclude meaningful tax treaties with serious implications for Canadian participation in the growth of international trade and finance.

1. WITHHOLDING TAXES

It is unfortunate that the White Paper ignores clear trends in international taxation, particularly evidenced in the widely followed OECD model tax convention and recent EEC developments, with regard to withholding taxes on interest, dividends and royalties.

We realize that because of the substantial investment in this country by United States residents, Canada is in a very awkward position with regard to withholding taxes in general, and on dividends and interest in particular. However, we feel that the Government should try to discourage (if it so desires) foreign investment and outflow of corporate earnings by other means than by adopting a rigid tax attitude on international capital flows in general. In paragraph 6.9 of the White Paper it is recognized to be in Canada's interest to maintain an international climate hospitable to the unrestricted flow of capital across international boundaries. Withholding taxes presents formidable barriers to such flows.

The raising of withholding taxes on payments to non-treaty countries to 25 per cent amounts to a further discrimination against such countries, adding insult to the injury described in chapter II. Unless assurance exists that Canada will have treaties with all developed and most developing countries, this proposal should not be adopted. This proposal appears largely based on excessive fears of Canadian tax avoidance but similar to the proposed two restrictions on the foreign dividend exemption (chapters II and III) it would result in "overkill", imposing severe penalties on bonafide Canadian borrowers.

With the proposed measure against thin capitalization, which obviously needs much refining, it would be no longer essential for Canada to maintain a high withholding tax on interest payments between affiliated companies. The rigid application of the 15 per cent withholding tax on interest is probably the most important reason why Canadian companies, hard hit by the credit squeeze, have generally not been able, as companies in almost all other countries have been, to borrow abroad funds desperately needed for domestic or foreign investments. There is a certain measure of unfairness in that federal, provincial and municipal authorities, not restricted by withholding taxes, have freely borrowed abroad to satisfy their financing requirements.

The proposal to impose a flat rate of 25 per cent on pension payments to non-residents results in unduly harsh penalty on persons usually least able to bear it. It is also contrary to

generally accepted international tax principles stated in the OECD model treaty. White we do not want to comment on this in detail, we feel that there is justification for amending this proposal to provide for tax being imposed on non-residents' pensions at the same rates that would apply had the pensioner remained in Canada, with a maximum of 25 per cent. At the same time, the non-resident pensioner should be able to claim a credit against Canadian tax for tax paid in his country of residence which, under internationally accepted standards, has first right to tax his pension.

2. CAPITAL GAINS

It is clear that the White Paper proposal to tax non-residents on actual or deemed realization of "Canadian" capital gains will create serious difficulties in the negotiation of tax treaties, particularly with the United States. The proposal is diametrically opposed to the OECD model treaty and will probably be unacceptable for otherwise willing treaty partners. We also question the wisdom of this proposal in view of the certain retaliation by other countries that will proceed to tax Canadians on "foreign" capital gains - for which, of course, Canada would have to allow full foreign tax credit.

With regard to the proposed tax on capital gains realized by Canadian residents on foreign assets, we urge that three areas are of great importance for Canadian companies with foreign subsidiaries.

(a) Detailed guidelines are essential with regard to valuation of foreign assets, particularly foreign subsidiaries, to avoid the problem of unsavory and prolonged retroactive conflicts with the Department of National Revenue.

(b) Credit for foreign taxes paid on gains on foreign assets should be allowed in Canada - particularly since Canada proposes to assume the right to tax non-residents on gains on Canadian assets.

(c) Broad roll-over provisions similar to those proposed for domestic reorganizations should apply to foreign reorganizations as well, on the basic test of no change in underlying ownership (e.g. incorporation of a branch, spin-off of a subsidiary, merger between subsidiaries, etc.).

3. FOREIGN TAX CREDIT

An equitable foreign tax credit system is important for Canada's continued participation in international trade and finance. We are pleased that the White Paper proposes to remove one of the two inequities imposed by the present system, viz. the inability to carry forward unused foreign tax credits.

The White Paper does not deal with the other inequity, viz. the limitation of foreign tax credits on a per country basis, rather than an overall basis. Though this aspect is probably too technical for discussion in this brief, we would be pleased to discuss it with the Committee in more detail. We should merely like to recommend that the alternative basis of computation on an overall basis as allowed in the U. S. (Internal Revenue Code, S. 904) be seriously considered.

In fact, the White Paper introduces a new restriction on foreign tax credit that ranks with the two aforementioned restrictions in inequity. We refer to the proposal to limit the maximum foreign tax credit on foreign investment income to 15 per cent. This appears to be based on the Canadian Government's optimism that it will be able to conclude treaties with practically all the countries in the free world, and that in such treaties the foreign withholding tax will be limited to 15 per cent.

For reasons outlined elsewhere in this brief (chapter II. 2) it is inevitable that there will be a majority of countries that will not have treaties with Canada in the foreseeable future. Also,in view of the unaccommodating attitude of the White Paper proposals with regard to non-residents, there is some likelihood that even in treaties, the 15 per cent limit on withholding tax is not a foregone conclusion.

Accordingly, we feel that the proposed 15 per cent limit on foreign tax credit is unjustified, and that it should not be implemented. No significant revenue gain could result from the White Paper proposal, and it would be a severe penalty on Canadian taxpayers with investments in the many countries that levy withholding taxes in excess of 15 per cent, particularly again the developing countries, a tax treaty with whom appears unlikely.

4. CONCLUSIONS AND RECOMMENDATIONS

The above mentioned aspects of the White Paper proposals would isolate Canada from the world-wide trend towards closer cooperation and international outlook in taxation. Insofar as they

discourage Canadians from investing abroad, particularly in developing countries, they conflict with Canada's foreign policy and the Canadian Government's attempt to assist Canadian investment in such countries as evidenced in Section 34 of the Export Development Act. In addition, they could seriously jeopardize Canada's ability to conclude meaningful tax treaties.

We suggest that it is in Canada's interest to adopt a policy of adhering closely to the OECD model treaty. Not only will this facilitate the negotiation of tax treaties, but it will be a demonstration of Canada's readiness to maintain a climate hospitable to international flows of capital.

We recommend that serious consideration be given to a special rule exempting from withholding tax Canadian companies borrowing abroad to finance foreign activities. Many countries, including the United States, have exemptions for such "foreign borrowing vehicles."

Finally, we recommend that the proposed 15 per cent limit on foreign tax credit should be rejected, and that the foreign tax credit should be broadened to allow computation on an "overall" basis.

VII. TAXING THE INDIVIDUAL - INTERNATIONAL ASPECTS

SUMMARY

The subject of personal taxation is primarily an issue of internal Canadian social and economic policy. We feel, however, that it has some important international aspects, and we have limited our comments to some of these aspects.

Canada should not impose taxes significantly more onerous than the United States.

Taxation of capital gains deemed realized upon departure from Canada could be very harmful to Canada unless it is refined to achieve only its purpose, i.e. elimination of tax avoidance.

This and some other aspects of the capital gains tax proposals may cause inequities in the international environment.

1. CANADA SHOULD BE COMPETITIVE IN PERSONNEL MARKETS

It is of vital importance for Canada to maintain a climate hospitable to the free movement of people. Canada's ability to attract and keep qualified foreign and Canadian talent has been and will remain essential for Canada's development.

It is clear that Canada's main competitor for qualified personnel is the United States. While many factors will influence an individual's choice between Canada and the United States, personal tax considerations are often important among them, particularly for individuals in the middle and higher income brackets.

Canada should, therefore, not adopt a personal tax rate schedule significantly exceeding that of the United States. The Canada-U.S. personal tax differential is well recognized, and only two additional comments need be made on this.

The tax increases in the middle income group proposed by the White Paper, when combined with the recently enacted reductions in the U.S. tax, will enlarge the existing differential.

As a result, Canadian employers would find it even more difficult and expensive to attract internationally mobile and competent personnel, and to keep qualified Canadians from moving to the United States.

It has been our experience that the U.S.-Canada tax differential has become a significant payroll cost factor. Thus, the higher Canadian tax has in effect become a tax on the employer with serious consequences for the competitiveness of Canadian companies in Canadian and foreign markets.

2. CANADIANS MOVING ABROAD

We believe that the benefits to Canada of the freedom of Canadians to move abroad are obvious and need no further clarification.

The deemed realization on departure from Canada is a formidable barrier to free personnel movements in and out of Canada. We submit that this proposal, if at all adopted, should be tailored to the objective sought, i.e., elimination of avoidance of Canadian tax. This could be achieved, e.g., by broad roll-overs for foreigners temporarily resident in Canada, and Canadians living abroad for a reasonably short time as well as a "de minimis" rule exempting, say, gains under $100,000.

Because the employer would normally be expected to reimburse the employee for this tax, the tax on employees leaving Canada will in most cases effectively be a tax on the Canadian employer. This additional cost would be a strong disincentive to the employer, with serious implications for growth of Canadian business abroad, and perhaps most important, for the development of Canadians by overseas training and experience.

Some aspects of the White Paper proposals on capital gains tax may result in double taxation. We do not want to discuss this very technical aspect further in this brief, but wish to point out that real hardships and inequities could result if appropriate relief is not available.

VIII - SMALL BUSINESS

Although the proposed removal of the low tax rate on the first $35,000 of corporate income has only marginal effect on the tax position of Massey-Ferguson itself, it could have serious consequences for our Canadian dealers.

The average Canadian agricultural machinery dealer is usually severely undercapitalized and forced to cope with seasonal and often widely fluctuating business conditions. Because of this he is particularly sensitive to the removal of the low rate which would result in higher cost and consequently higher machinery prices to the Canadian farmer.

The low rate, in effect, provides a possibility for deferral of tax, thus assisting the small businessman to retain urgently needed cash in his company. If integration is adopted as proposed, full personal tax would have to be paid within 2-1/2 years on the entire profits of the corporation. We urge that in this time of extreme money shortage the removal of this possibility for small business to defer taxes is ill-advised and unnecessary.

The White Paper gives three main reasons for this proposal:

First, that it is not justifiable to give tax advantages to corporations and not to unincorporated businesses. We submit that in most cases these unincorporated businesses could be converted into corporations if the tax advantages were significant, for example, if the marginal rate of the owner exceeds 25 per cent or if he wishes to retain earnings in the business.

The second reason is the possibility of evading tax by operating a string of small companies rather than one large company. We feel that the associated company rules and the judicial interpretation thereof have in fact put an almost complete stop to this method of evasion, and that this is no longer a valid argument.

Thirdly, and this is probably the most serious, the White Paper recognizes implicitly that in a system that integrates personal and corporate tax continuance of any incentive by way of tax reduction or deferral

results in burdensome and possibly inequitable administrative complications. This is one of the major disadvantages of integration as indicated in chapter V.2.

We suggest that the low rate on the first $35,000 of corporate income should be maintained. If necessary, it could be tailored to fit the small business concept by confining its applicability to companies not exceeding a certain size defined in terms of assets, personnel and/or turnover. Where this conflicts with the integration system, we think the latter should be adjusted as recommended (chapter V.9).

APPENDIX B

SUBMISSION ON TAXATION POLICY

to the

STANDING SENATE COMMITTEE ON BANKING, TRADE & COMMERCE

and to the

MINISTER OF FINANCE FOR CANADA

May 15, 1970

Fédération Canadienne de l'Agriculture
Canadian Federation of Agriculture
111 Sparks Street
Ottawa

SUBMISSION ON TAXATION POLICY
to the
STANDING SENATE COMMITTEE ON BANKING, TRADE & COMMERCE
and to the
MINISTER OF FINANCE FOR CANADA
by the
CANADIAN FEDERATION OF AGRICULTURE
May 15, 1970

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1. The Canadian Federation of Agriculture in general supports the basic intent of the "Proposals for Tax Reform" of the Honourable E.J. Benson's White Paper. Specifically, it endorses the giving of relief to lower income taxpayers, and the broadening of the tax base.

2. Accordingly, we do not oppose in principle the application of a capital gains tax. But farmers are deeply disturbed that in an effort, in the interests of equity, to effectively tax real incomes that now take the form of capital gains, highly inequitable and indeed confiscatory results will flow from application of the White Paper proposals as they now stand. We are concerned both from the standpoint of equity, and from the standpoint of the impact of the proposed new tax system on the continued viability of the individual family enterprise in agriculture.

3. We greatly fear that the combined results of the capital gains proposals and of estate taxes and succession duties will as the years go by place intolerable strains on the maintenance of the family proprietorship system in Canadian agriculture. Even apart from tax problems, special and very difficult problems of financing and refinancing family farms of an economically viable size exist and are increasing. The tax system should not add to these difficulties.

Estate Taxes

4. This submission must include, as a major aspect of it, the question of estate taxes and succession duties. At the time of introduction of the new Estate Tax the Hon. E.J. Benson said:

> "...I believe the estate tax question should be opened and reviewed within a relatively short period of time, especially in view of the tax reform coming, on which we hope to introduce a White Paper relatively soon. When we have done this for that package, plus estate tax (as has been done), we should have a clear look at it again and I can give an undertaking that we will be looking at it and re-opening the Act in the near future, to take care of some of these shaking down conditions."

5. Apart from imposition of capital gains taxes, estate taxes at the levels provided in the Estate Tax Act are already excessive and a major difficulty and obstacle to the maintenance of our family enterprise system of farming. In relation to the size of capital requirements for even modestly efficient farming and business enterprises in our modern economy, basic exemption levels for estate tax purposes are far too low and rates too high. Year by year this will become increasingly so. For the farmers of some provinces, of course, this is a much more serious problem than in others, due to differences in provincial taxes and tax policy with respect to estate taxes and succession duties.

6. Very substantial increases in basic exemption levels, and lowering of rates of estate taxes should unquestionably be provided.

Capital Gains Taxation

7. Three basic principles absolutely, in our view, must be adopted and applied regarding capital gains taxation. They are:

(1) There must be no realization of capital gains on farms as long as they remain continuously in the family succession of

ownership, whether the passing on of the business is by sale or inheritance.

(2) There must not be taxation of gains in capital value which are not real gains, but which merely reflect the decline in the value of the dollar due to inflation. To tax such gains is not taxation of gains at all, but confiscation.

(3) There must be provision for lump sum investment by farmers, on realization of capital gains, in retirement savings plans, and deductability of such investments from taxable income.

8. These, combined with lowering of estate taxes, are the essential ingredients of a tolerable policy, both in the interests of equity and in the interests of maintenance of economically viable family farm enterprises. The issue is one of the greatest importance.

9. Realization: The White Paper proposals of course provide, as they should, that there is no taxation of capital gains on inheritance, but only on subsequent sales of a property. This of course is a valuable provision, but it is not sufficient. The same should apply to the transfer of the farm prior to the father's death, if this sale is to the son, and not sold out of the family. It should apply also to sales of a farm, or portions of it, if the capital gains so realized are re-invested in farming in Canada, by the farmer, with a period of one year.

10. The Inflation Factor: To impose a capital gains tax on farm land without adjustment for inflation would amount to a system of progressive confiscation. Consider, for example, a farm valued at $100,000 on valuation day and sold twenty years later for $150,000. If in that time a 30% inflation had taken place

it could by no stretch of the imagination be argued that more than $20,000 of the increase in value represented a real appreciation in value. No amount of theorizing can get around this fact. Farmers cannot accept a proposal having a built-in element of confiscation. The inflation rates inherent in this example are of course extremely moderate and would likely be substantially higher in fact.

11. Unless this problem of the inflation factor in capital gains is recognized, and methods developed to deal with it, the Federation will be forced to oppose introduction of a capital gains tax on any form on farm property. Perhaps indeed to abandon taxation of longer-term capital gains on farm property would be the best way of dealing with the problem.

12. If the taxation of capital gains on farms is to be retained, then an inflation index deflator must be applied to the gain, reducing it for taxable purposes by the amount of increase in the index that has occurred during the period during which the capital gains have accumulated. We would suggest the shelter component of the consumer price index as an appropriate measure, in view of the major importance of the cost of shelter to a retiring farmer.

13. Registered Retirement Plans: Farmers, along with many other small businessmen, are not normally in a position to take advantage of the tax benefits involved in investment in registered retirement savings plans. They need all the funds that they have available for investment in the farm. That farm is their retirement

fund. We propose that when a farmer sells his farm, and there is a realization of capital gains, that he be permitted to reduce the taxable amount of them by investing them in a registered retirement savings plan up to an amount sufficient to give him a reasonable annuity at age 65.

14. Once-in-a-Lifetime Gift: The requirement that a once-in-a-lifetime tax exempt gift of farm property from father to son is added back into the estate for tax purposes if made less than three years before death of the father should be abandoned. There seems to us little logic in this restriction.

15. Averaging Back of Capital Gains: On sale of a farm, and realization of capital gains, the farmer selling should be considered a farmer for purposes of averaging back those capital gains on a five year basis. If this is not the present intent, it should be so. Even this is really not adequate, in fact. Farmers' earnings from agriculture during their lifetime are frequently very low, and a strong case can be made, in the case of capital gains, for setting rates of tax at a level which reflects his average taxable income over the period from valuation day.

16. Farmer Retirement in Closely Held Corporation: It should be possible, in a closely held farm corporation, for a farmer to retire while retaining his interest in that corporation, and to live in another country, without taxation of capital gains being imposed. The land is there, and this restrictive provision would seem to be unnecessary.

17. Initial valuation: Where an asset is purchased at a value higher than its value on valuation day, for purposes of capital gains calculation the actual cost to the owner will, we assume, be recognized as the initial valuation. Any other rule would be thoroughly unjust. Beyond this, however, it is clear that for those persons holding assets that are at depressed price levels at valuation day, there will often be an inequity involved in taking this valuation for estimation of capital gains. This problem may well apply to a great many farms in the prairie provinces, for example. Some account should be taken of this difficulty. It has for example been suggested that a capital gain should not in any case be greater than the number of years since valuation day, times the average annual increase over the whole period of ownership of the asset. This would have application, of course, only to property purchased prior to introduction of the new system.

18. Principle Residence: We think the provision for a $1,000 per annum addition to valuation of farms which are the principle residence of the farmer, for purposes of calculating capital gains, is a sound one. We would however, have two or three recommendations to make in this connection:

(1) There should be provision, in the case of farms, for crediting $1,000 per annum to more than one principle resident, where there is a family operation, and ownership in the farm is shared.

(2) The principle residence credit should be available of course whether the farm is incorporated or not.

(3) The $1,000 a year should be credited, where rollover provisions are in effect, for the whole period of residence of the house, which of course may have changed hands from father to son during the period.

19. Valuation on Inheritance: Where a farm is inherited, the full amount of all estate and succession duties, and legal costs, should be added to the initial value of the farm, for purposes of later calculation of capital gains. This is a definite requirement for equity of treatment. These tax and legal costs are real and onerous, and they should all, not merely a part of them, be applied to increase the valuation for capital gains purposes.

Averaging

20. We appreciate the retention of the present 5-year averaging option for farmers, in addition to the more general and limited averaging provision being proposed. Both systems cannot of course be applied in the same taxation years, and the observation has been made by one tax expert, we have read, that problems could arise for farmers here. He said: "With the central tax assessment computer presumably making the choice of the general averaging provision, this may lead to considerable difficulties for farmers later wishing to average on the existing basis". We would only make the point here that the law and regulations should be looked at to ensure that the automatic averaging cannot exclude the farmer from best use of the alternate provisions which will be available to him.

Depreciation

21. Farmers welcome the government's proposal to leave optional the method of calculating depreciation, but agree that the declining

balance system will become more widely used with the elimination of the opportunity to realize "capital gains" on the sale of farm machinery. We would like to point out however, that typically in farming there is continuous pressure to expand investment in new machinery and other assets to meet changing technology. (On some items rates of depreciation are too low in relation to the life of the asset.) Technical obsolescence on many farm assets can be very rapid.

22. Farmers are faced with an increasing need for capital for financing economic farm adjustment, and to meet the requirements of rapid technological change. On all depreciable farm assets the rate of allowable depreciation should be placed at 20% straight-line method and 40% declining balance method. We think that this is a fair and very simple solution to the depreciation rate problem in farming.

Basic Herd

23. The basic herd was designed to do two things. First, to recognize a portion of a farmer's herd as original capital, properly not taxable as income on disposal, and second; to provide a method whereby a farmer might, by adding to his herd out of income, add to his capital investment in livestock. The basic herd is defined in units of livestock, not in dollars. The White Paper proposal is to eliminate this system (but recognizing the value of existing basic herds on valuation day as capital deductible in calculating income from the proceeds of subsequent sales). It is true of course that the introduction of capital gains adds another dimension to this question, but in our view the basic herd should be retained. In the first place, in general the price outlook for livestock is

not such as to make the likely accumulation of capital gains very great. In the second place it is a sound principle to establish a capital asset in the form of at least a part of the farmers' herd.

24. Finally, in this connection, we would draw attention to the tax problem created for a farmer who wishes to switch to the accrual basis of accounting, with the result that his livestock inventory is brought fully into income in the first year. We believe, as we have recommended previously, that there would be merit in allowing those who wish to start on the accrual system to do so without incurring tax on the inventory taken in at the time of changeover. As an alternative, softening the tax impact of such a changeover, provisions should be developed, such as applying the amount forward over a period of 10 years.

Earnings of Dependents

25. Farmers face, of course, the inequities associated with "less than arms length" contributions by wives to the earnings of the farm enterprise. Such earnings should be allowed if actually paid in the name of the wife, and it can be reasonably shown that she made an equivalent contribution to the work of the farm. This can be done now where there is incorporation. It is quite unfair and inconsistent to not permit it simply by reason of absence of formal incorporation.

Valuation

26. Valuation, in connection with capital gains, is clearly for farmers often going to be a critical question. It is our understanding that no general attempt is going to be made by government to establish v-day evaluations, and the issue will arise only when there is realization on the farm or part of it. In that event no doubt the starting point will be the farmers' own valuations,

subject to review by government, if it appeared necessary. The basic principle to be applied in these matters should be that the essential burden of proof, and of the expense involved in resolving valuation problems, should rest not on the taxpayer but on the government. The taxpayer should be presumed innocent unless shown to be guilty.

27. Procedures regarding valuation, and the rules and regulations, should be very clear, both respecting the v-day valuation and the valuation on realization. When there is an arms length sale, of course, the latter will be clear. Government policy with respect to less than arms length sales will have to be laid down. What the property-owner should do to protect himself against possible unfair initial valuation should be examined and clarified.

28. The principle problem in determining market value is the danger of using, without sufficient critical examination, the criteria of market values placed on "similar" properties in the area. There are so many variables and special circumstances involved in the setting of proper values of individual properties that trained and well-informed evaluators are required to give a proper result. Inevitably there will be disputes.

29. It is our view that when there is a dispute on valuation, it be a matter of government policy that the property-owner have the right to have an independent valuation made, in addition to that obtained by the government, by qualified professionals, and that the cost of such valuation be borne in a proportion of 75% by the government and 25% by the farmer.

30. We would note that when, at provincial level, uniform assessment at market value for property taxes is introduced, this will, besides being desirable from a property tax point of view, be of great assistance in the capital gains tax process.

31. Finally, we would recommend that the government publish, at an early date, a detailed draft statement of proposed regulatory and legislative provisions respecting valuation problems, so that this can be given public scrutiny and debate.

Training Costs as Expense

32. An important need for many farmers is to avail themselves of attendance at short courses and other forms of training, while continuing the operation of the farm. It is very desirable that such training be taken, and it represents a necessary cost of doing business properly. We recommend that in addition to the cost of hired help when away from home, which would in any case be deductible, that travelling, tuition and living costs on such courses be allowed as a business expense.

33. In this general connection we are confident that the intent of the stricter rules planned for definition of allowable business and convention expense - an objective we support - is not intended to add, to income, expenses incurred by farm representatives attending business meetings of their organizations.

Integration of Federal-Provincial Tax Law

34. Last, but by no means least, we would like to emphasize the great importance of all governments applying themselves with great diligence to ensuring that the combined effect of the taxation system as a whole is equitable to the taxpayer. It is

not merely a matter of reconciliation and co-ordination of particular shared jurisdictions, such as succession duties, but of the overall tax burden. Of particular concern to us is the problem of excessively heavy reliance on property taxes - especially but not exclusively farm real estate taxes - particularly as a means of meeting the costs of education. Some means should be worked out of reducing this reliance, and ensuring an equitable bearing by all of the total tax burden.

35. We would emphasize very strongly that the present White Paper proposals, combined with the Estate and Succession duties now imposed, represent a policy for taxation of farms that farmers cannot accept. We do not view the proposals contained in this submission as alternatives. They have not been conceived in this way. They are all necessary and should be applied, on grounds of equity and the continuation of family farming. We recognize of course that for a great many farmers their holdings are not of a size or value, and will not reach such a size in their lifetime, as to make many of the problems we have raised here of major significance to them. These especially will benefit from the personal tax exemption provisions, and the general broadening of the tax base. But our recommendations do have vital meaning and significance for almost all farms which now are of a size, or will become of a size, that gives them the chance of achieving economic viability in the midst of advancing technology. It is the future backbone of the farming industry with which this submission deals.

Respectfully Submitted
Canadian Federation of Agriculture

SUMMARY OF MAJOR RECOMMENDATIONS

1. Substantial reduction of estate taxes and succession duties.

2. Assurance of continuous family ownership of the farm without realization of capital gains until sold outside the family.

3. Adjustment of capital gains downward to take account of inflation, or, failing this, abandonment of the taxation of longer term capital gains on land.

4. Provision for investment of capital gains in registered retirement funds, tax exempt, except as received in retirement income.

5. Flexible opportunity for farm adjustment through sale of some assets and re-investment in others, without capital gains realization.

6. Adequate provision for averaging back of capital gains.

7. Initial value for calculation of capital gains at not less than cost to the farmer. Adjustment for depressed land values at valuation day, where they occur as a result of farming conditions.

8. On inheritance, addition to initial valuation of all estate taxes, succession duties, and legal costs of the transfer of the estate.

9. Recognition of separate principle residence for each farm operator in family joint operations, partnerships, corporations or co-operatives.

10. Retention of 5-year averaging provision.

11. Retention of the basic herd system.

12. A standard maximum rate of depreciation on depreciable farm assets of 20% straight line and 40% diminishing balance.

13. Recognition of earnings of wives from work for the farm as expenses of farmer.

14. Acceptance of government burden of proof in case of disputed valuations, and payment of 3/4 of cost of independent valuation by farmer, when this is required for his protection.

15. Early publication of detailed information on valuation procedures and rules, and proposed regulatory and valuation procedures.

16. Allowance of training costs as an expense of doing business.

17. Careful Federal-Provincial examination of overall tax system to ensure equity of treatment, and relief from burden of education costs on real property taxes.

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APPENDIX C

A BRIEF

from

THE LEAGUE OF CONCERNED CANADIANS

to the

SENATE COMMITTEE

on

BANKING, TRADE AND COMMERCE

March 31, 1970

A BRIEF

from

THE LEAGUE OF CONCERNED CANADIANS

INTRODUCTION

The League of Concerned Canadians was formed January 23, 1970, by an initial group of individuals from various walks of Canadian life to review and examine the "Proposals for Tax Reform" issued November 7, 1969, by The Honourable Edgar Benson, Minister of Finance for the Canadian Government. This group is not associated or affiliated in any way with any political party or any other organization.

SYNOPSIS OF BRIEF

The government has asked for a dialogue on its proposals. The proposals have far reaching implications, but these are not fully documented, if indeed they are known to its architects.

If the federal government wishes to draw on the collective brains of all Canadians through "participatory democracy", it is our opinion that:

either, the Paper should be withdrawn for further study by the Department of Finance, and others in government, until the supporting data promised by the Minister are available to every one;

or, the time constraints established by the Parliamentary Committees should be lifted, and extended for an indefinite period to permit a full dialogue.

This brief establishes the areas of concern to The League of Concerned Canadians. It presents some specific observations in support of these concerns. If time is of the essence, we suggest the government should present its tax proposals in a bill before the House of Commons for full debate according to the normal parliamentary process. If time is not of the essence, we suggest again that the government should make available all relevant details, e.g., the future relationship of direct to indirect taxation, to all Canadians so that each can participate in the dialogue in an intelligent manner.

The League of Concerned Canadians believe that a much more cautious approach to tax reform is in order because the proposals put forward in the White Paper may well harm:

1. our rate of economic growth,

2. our ability to attract capital in world markets,

3. our ability to generate capital from internal private sources,
4. our competitive ability to trade with other countries,
5. our ability to retain our talented and productive people, educated at Canadian public expense.

In other words, we wonder if the government is correct when it states "....they (i.e. the proposals) are the best practical proposals to attain our objectives in present circumstances."

INTRODUCTION

The League of Concerned Canadians was formed January 23, 1970, by an initial group of individuals from various walks of Canadian life to review and examine the "Proposals for Tax Reform" issued November 7, 1969, by The Honourable Edgar Benson, Minister of Finance for the Canadian Government. This group is not associated or affiliated in any way with any political party or any other organization.

THE GOVERNMENT'S STATED OBJECTIVES

The Government of Canada states "In this White Paper .... (it) .... places before Parliament, the Canadian people and the provincial governments, its major proposals for reform of the income tax structure." (Section 1.1)

The report goes on to say: "The government's proposals are the result of careful study of tax principles, practices and impact. The government believes they are the best practical proposals to attain our objectives in present circumstances. They are advanced for discussion and review in the light of that discussion before Parliament is asked to approve a bill to implement tax reform ...." (Section 1.4)

The Government of Canada then gives its aims for tax reform: "A number of goals and standards have guided the government in its approach to reform. They include a fair distribution of the tax burden based upon ability to pay; steady economic growth and continuing prosperity; the recognition of modern social needs; widespread understanding of and voluntary compliance with the tax laws, combined with enough detail to block loopholes; and finally, a system that can and will be used by the provinces as well as Canada."

(Section 1.6)

GENERAL OBSERVATIONS

These are sound objectives, but are they not the individual and collective philosophy of each federal administration since 1867, and not just the present government?

It seems to us that the hue and cry which has developed across Canada suggests there are some serious and fundamental deficiencies in the White Paper beyond that which may be propounded by any narrow vested interest or by any group with a desire for political gain. It also appears from our limited resources for review and analysis that the implications of the proposals go well beyond that envisaged by its architects, and that perhaps a more careful well-scheduled series of changes are in order.

It is our view that the difficulty which Canadians are having in coming to grips with the proposals in the White Paper is because several objectives, as stated earlier, have been put forward and inappropriately combined in one document, for example:

(a) economic objectives,

(b) sweeping but incomplete tax changes,

(c) tax reform,

(d) an incomplete reference to the fiscal needs of the provinces, and

(e) tax administration.

The League of Concerned Canadians have no quarrel with the need for tax reform. We have no quarrel with the general and broad objectives of fairness and equity in the approach to the income tax. We are concerned with the economic consequences and the effect on the people.

Recognizing that our resources for review and analysis are miniscule compared to the apparatus behind the authors of the White Paper, The League of Concerned Canadians believes that the Minister of Finance may well be wrong when he states ....

> "the tax reform proposals set forth in this paper are expected to have relatively modest impacts upon the Canadian economy ...." (Section 8.35)

It is our view that it is better to err on the side of economic growth than to "plump" for the virtue of a fair and equitable (in the eyes of the authors) tax system, if it is not possible to predict with reasonable certainty the consequences to the economy of these tax reforms.

We say this because we believe the implementation of these proposals will tend to increase the private sector's spending and decrease its savings, which will diminish the rate of growth, all else equal. If this is a valid assumption, then the authors of the White Paper must have assumed that the public sector's savings (or spending) will fill the gap in order that the proposals will have "relatively modest impact".

It seems to us, further, that this increased pool of savings in the hands of the public sector presupposes increased investment by the public sector for economic growth to continue undiminished. Either way the role of government will grow. It is possible of course, for economic growth to be sustained by making the assumption that increased private spending will support increased private investment in a less direct manner. The suggested changes in the personal income tax rates do not support this view.

The League of Concerned Canadians also questions the "modest impact" statement on the grounds that our international trading position may well be damaged.

Thus the net result of the proposals in our opinion is for a diminished rate of economic growth and/or a shift to the public sector of the impetus for economic growth.

It is fundamental to our position that the White Paper has underestimated the impact of the tax changes on government revenues, is silent on the growth of government revenues arising from the proposals, is silent on the growth of expenditures by all levels of government; and thus fails to present a reliable picture of the future relationship between the private and the governmental sectors of our economy.

RECOMMENDATIONS

The government has asked for a dialogue on its proposals. The proposals have far reaching implications, but these are not fully documented, if indeed they are known to its architects.

If the federal government wishes to draw on the collective brains of all Canadians through "participatory democracy", it is our opinion that:

either, the Paper should be withdrawn for further study by the Department of Finance, and others in government, until the supporting data promised by the Minister are available to every one;

or, the time constraints established by the Parliamentary Committees should be lifted, and extended for an indefinite period to permit a full dialogue.

This brief establishes the areas of concern to The League of Concerned Canadians. It presents some specific observations in support of these concerns. If time is of the essence, we suggest the government should present its tax proposals in a bill before the House of Commons for full debate according to the normal parliamentary process. If time is not of the essence, we suggest again that the government should make available all relevant details, e.g., the future relationship of direct to indirect taxation, to all Canadians so that each can participate in the dialogue in an intelligent manner.

SPECIFIC OBSERVATIONS

1. Tendency to increase spending and decrease savings by the private sector.

   (a) The removal from the tax rolls of an estimated 750,000 Canadians (for the time being) and the reduction in taxes on several million more in the lower tax brackets will tend to increase spending.

(b) Taxes will be increased for a large body of Canadians, particularly for those who are now, and would otherwise become, the small investors of this nation. The following tables illustrate:

Comparative Personal Tax Rates

(Married man: - 2 children under 16, Resident in British Columbia)

Salary Income	Present Tax	Proposed Tax	% Increase
$13,000	$2,677	$2,839	6.1%
15,000	3,414	3,590	5.2
17,000	4,238	4,372	3.2

(Note: A tax on capital gains is in addition.)

(Single Man Resident in British Columbia)

Salary Income	Present Tax	Proposed Tax	% Increase
$ 8,000	$1,657	$1,780	7.5%
10,000	2,229	2,481	11.3
12,000	2,894	3,206	10.8
15,000	4,073	4,372	7.3
20,000	6,334	6,574	3.8

(Note: A tax on capital gains is in addition.)

(c) The additional tax burdens to be placed on the small business will reduce retained earnings (savings)

and hence retard growth. The result of the White Paper proposals will be to increase the tax on small business up to an amount of $10,500 per year.

(d) A tax on capital gains at full income rates will hinder savings and hence investment. There should be no tax on capital gains on family homes and on personal property. Nor should it apply on unrealized gains.

(e) Modest trusts for educational or savings purposes for minors should be encouraged and not taxed out of existance.

2. Damage to our International Trading Position, and Diminished Economic Growth.

(a) If the proposals are to have "relatively modest impacts on the Canadian economy ....", it must have been assumed that economic growth will continue as in the past. Under these circumstances, foreign capital inflows proportional to total capital required must continue in the future. This is not likely.

(b) Resource industries - e.g. mining and oil - have contributed to the past economic growth of Canada. It is debatable whether or not these industries have created regional imbalances, or have acquired a disproportionate share of the total national inputs.

It is not debatable that risk is inherent to these industries. Thus if the after tax return is affected, the relationship of return to risk is changed. Is it sound for Canada to be down grading these resource industries in the future compared to the past, and in Canada relative to competitive industries elsewhere in the world, particularly when world capital is in such short supply?

It is admirable to be innovative and daring, but is this the role for Canada in taxation at this time, and in this way?

(c) The imposition of higher withholding taxes with non-treaty countries and a tax on capital gains made by non-residents in Canada at full income tax rates will discourage foreign investment.

3. Managerial and Professional Ability.

(a) The White Paper (Section 2.39) says "Canada needs the full effort of those with outstanding ability. It must compete for such people with other countries where able Canadians can go to live and to work if they wish."

The proposed income tax changes in the White Paper, and the enactment of the United States Tax Reform Bill

late in 1969 widens the gap between Canadian and United States personal income taxes. (See Table.) If these changes should result in the net loss of one person whose talents and abilities are needed in Canada, our economic growth will be harmed.

Comparative Tax Rates - Canada/U.S.

Income 1970	Present Tax	Proposed Tax	U.S. Tax
$13,000	$ 2,865	$ 3,083	$1,101
18,000	5,008	5,206	2,537
25,000	8,504	8,604	4,806
30,000	11,129	11,273	6,563

Notes:

i. Married, two children under 16, house mortgage $30,000 at 8%, property taxes of $1,000.

ii. U.S. tax after their tax reform bill, and for State of Minnesota.

iii. Canadian tax for Manitoba

4. Role of Government

(a) The White Paper has underestimated the revenue impact of its proposed direct tax changes, according to public reports.

The White Paper, Section 8.1, suggests that the federal and provincial income tax yield under the proposed system would be $165 million more than at present for 1969.

The White Paper was issued on November 7, 1969. Actual revenues for the third quarter of 1969 under the present system were $239 million more than estimated. (See Table.)

	Present System		1969 (ii) Proposed System
	1969 (i) Actual	1969 White Paper (ii) Estimate	
		(Millions of dollars.)	
Personal income Taxes	8,584	7,720	7,685
Corporation income taxes	2,396	3,075	3,285
Withholding taxes	264	210	200
Total	11,244	11,005	11,170

Notes:

1. Seasonally adjusted direct taxes at annual rates, 3rd Quarter 1969. Source - Budget Papers, March 2, 1970, p.113.

ii. White Paper, Page 85.

(b) If the government can be $239 million in error on a 1969 revenue estimate made in November, 1969, after ten full months of receipts, is it reasonable for the Canadian public to accept its fifth year forecast of additional yield of $630 million? At this rate, the compound effect of the error in five years is over $1.2 billion, a serious under-estimate, based on actual 1969 tax yields only.

(c) The White Paper deals only with direct taxes - personal and corporate, and withholding taxes. The large area of indirect taxes - sales and excise, custom duties, estate taxes, succession duties - make up for more than half of total government revenues. If spending is to increase, are not the revenue yields from these sources important to the dialogue on economic consequences?

(d) The Economic Council's forecast of increased government expenditures (Sixth review - page 82) suggests a requirement of $37.3 billion (1967 dollars) at potential output in 1975, an increase of about 7% per year.

Is it not reasonable to ask the authors of the White Paper to estimate future government expenditures for all levels of government, if necessary in consultation with these other governments; and then to comment on the economic consequences of the White Paper from the point of view of all sources of revenue?

CONCLUSIONS

The League of Concerned Canadians believe that a much more cautious approach to tax reform is in order because the proposals put forward in the White Paper may well harm:

1. our rate of economic growth,
2. our ability to attract capital in world markets,
3. our ability to generate capital from internal private sources,
4. our competitive ability to trade with other countries,
5. our ability to retain our talented and productive people, educated at Canadian public expense.

In other words, we wonder if the government is correct when it states ".... they (i.e. the proposals) are the best practical proposals to attain our objectives in present circumstances."

THE LEAGUE OF CONCERNED CANADIANS

APPENDIX "D"

WHITE PAPER PRESENTATION
MONTREAL KIWANIS CLUB INC.
TO
STANDING COMMITTEE ON FINANCE
TRADE & ECONOMIC AFFAIRS
HOUSE OF COMMONS
OTTAWA

WHITE PAPER PRESENTATION
MONTREAL KIWANIS CLUB INC.
TO
SENATE COMMITTEE ON BANKING
TRADE AND COMMERCE
THE SENATE
OTTAWA ONTARIO

WHITE PAPER SUBMISSION

KIWANIS CLUB OF MONTREAL INC.

FOR PRESENTATION TO THE HONORABLE MR. E. J. BENSON

MINISTER OF FINANCE

GOVERNMENT OF CANADA

Introduction Comment

While this submission has been initiated by the Kiwanis Club of Montreal its content is the result of careful and considered discussion with other Kiwanis Clubs within the "O.Q.M. District (Ontario, Quebec and the Maritimes) which in itself is comprised of 75 Kiwanis Clubs.

This evaluation has also been examined and discussed by the member clubs of the Inter Service Club Council of Montreal, and has been given the Council's full endorsation.

To verify the representative opinion that is expressed herein, we are pleased to attach official letters of endorsement from the various service organizations and their member clubs with whom it has been our privilege to explore this matter of mutual concern over the brief period of February 4-28, 1970.

It is significant that to this date there has never been an official analysis of the entire spectrum of Service Club activities in Canada to permit an accurate statistical evaluation of all phases of activities performed on a voluntary basis, either on a yearly basis, or for a more extended period of time, such as the past lo or 20 years in which important trends and changes have occurred.

Because the proposals under the "White Paper" strike at the very core of the "service club movement" in Canada, it is a most welcome opportunity for all service clubs to participate in such a general evaluation -- which we hope to achieve during the current year, for the future guidance and reference of the governments at all levels and for the public at large.

Of necessity, we are restricting the use of statistics in this submission to the bare minimum, in order to provide an adequate perspective on the points at issue. It is anticipated that when the complete set of authentic facts are correlated, there will be a much deeper appreciation at all levels of the very substantial contribution that is being made to the Canadian community by all service clubs and their members.

The Problem

We take the liberty of quoting your comments in your presentation of the White Paper on the subject of "Entertainment and Related Expenses":

5.9 (Quote)
"It is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the cost of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs."

5.10
"Under the system outlined in Chapter 4 whereby shareholders are given credit for the taxes paid by their corporations merely to deny a deduction for this purpose of expenditure is not sufficient, although the denial of the deduction would mean that the corporation pays extra tax, shareholders of the corporation would receive credit for the extra tax paid. Therefore it is necessary to provide further that, in the case of corporate tax payers, taxes due because of the non-deductibility of these expenditures would not be creditable.

General Observation

We respectfully submit that:

1. Service club dues and luncheon expenses should be recognized as legitimate business expenses, fully deductible from taxable income, for members who are official representatives of their business because:

   (a) By its very nature, a service club is a meeting place of business men whose membership qualification is closely related to the various categories of business they represent.

   (b) The corporate image of every firm is reflected by its representative member in the local Kiwanis, Rotary, Lions, Gyro, Active Club, Optimist, Richelieu or Civitan, etc.

   (c) The luncheon meetings in themselves are a necessary means of communication and motivation by which the collective manpower of each club is encouraged to support the many activities in which each club is involved. Without such luncheons, the whole service club activity pattern would "die on the vine."

   (d) The favorable personal relationships that are naturally created through service club activity are known to produce a desirable business liaison between members, especially in the sales and service areas. Where such results do not occur, even though it may not be the prime reason for membership, a corporation or private business is not normally found in the membership roster.

(e) The basic object of the service clubs is neither recreational nor social -- but rather to create a manpower pool that can effectively provide voluntary leadership to the many areas of public need -- whether it be in the area of charities, public and business affairs, youth development programmes, homes for the aged, Little League Baseball, retarded children's camps, vocational guidance, public education on drugs, traffic safety, pollution etc.

The conditions of membership in service clubs demand an understood personal commitment of voluntary participation and attendance, to ensure that these primary objects shall be achieved.

(f) Not only do the results of membership satisfy the traditional Income Tax definition of a "deductible expense" (an expense for the object of earning income)--- but the result of service club activity reduces greatly what would otherwise become a much larger expense by governments at local, provincial and federal levels to replace these services.

(g) If corporations are not permitted to deduct the service club membership dues and luncheons of their appointed members, the future membership strength of all service clubs is placed in jeopardy -- when 60% of all memberships (or higher) are company sponsored.

(h) If the Government of Canada wishes the business community to help keep the level of government expenditure down, by encouraging the employees to continue their involvement in community activities, it goes without saying that the government's taxation policy must favor this expenditure of employee man-hours in service club projects.

We respectfully suggest that the proposed amendment not only fails to recognize the value of donated corporate time to service club activities, but actually penalizes both the company and its shareholders if the expenses for membership dues and luncheons are treated as non-deductible expenses to the corporation --

We find it difficult indeed to understand your department's logic that tax credits normally given to shareholders pertaining to taxes paid by their corporations should be denied to them for such increased corporate taxes as may result by making these expenditures non deductible.

Can it be that it is the object of the Finance Department to encourage an "Anti-Service Club" attitude, not only by employers, but also by the shareholders of corporations?

While we are sure this is not the natural intent of the Government of Canada, it could well become the result. The problem is not just the action, it is also the reaction and its cumulative effects.

2. There is no indication in the White Paper of an intended budget increase to offset the loss of free services from service clubs that must be anticipated if the proposed amendment is allowed to affect service club dues and luncheon expenses. We suggest that this is a $100 million problem per year.

3. The total membership of all service clubs in Canada is presently estimated at 135,000. Of these 13,326 are Kiwanians.

   If local Chambers of Commerce and Junior Chambers (Jaycees) also brought under the "non deductible" expense interpretation, the total number of membership affected by the proposed ruling will approximate 200,000 in Canada.

   You would find it very difficult indeed to differentiate between the deductibility of local Chamber of Commerce memberships and service clubs, for both involve community activities designed to create a "desirable climate" socially, politically, economically and culturally in which business can best operate.

4. We question whether it is appreciated by the Department of Finance that the cost of replacing free services from service club members might well be more than 20 times the increased tax revenues anticipated from non-deductible service club dues and luncheon expenses.

   To illustrate -- we shall use only the figures officially related to service club membership in Canada.

Total service club membership	135,000
Average expense deduction per member (including dues and meals)	$150
Total possible expense deduction	$20,250,000
Less 25% non deductible due to membership classification	5,062,600
Net Deductions	$15,188,500

Likely Tax Revenues

(a) Small business representatives (2/3 of 15,188,500) x 22%	$2,256,465
(b) Large company representation (1/3x15,188,500) x 50%	2,531,416
Estimated tax revenues by disallowing service club dues and luncheons	$4,787,881

Evaluation of Canadian Service Club Activities

(a) Estimated Man Hours of Free Community Service
135,000 men @ 2 hrs/week = 100 hrs/yr = 13,500,000 man/hrs/yr

N.B. - Most clubs expect four hours per week by each member, with participation on 2 committees. The above assumption is ultra conservative.

(b) Estimated Value of "Company" Donated Time
135,000 hours @ $7.50 per hour (Minimum) $101,250,000

N.B. - Employee income average is estimated at $5,00/yr
- Income average for members from profess-ional and sole proprietors is estimated @ $8.00/yr.
- Company or business time donated is usually worth at least 50% more than earned income rate of member.

(c) Cash Benefits to Canadian Community per Year through Service Club Activity

(i) By personal donation to club projects:
135,000 x 50.00/member 6,750,000

(ii) By capital fund-raising activities:
135,000 x 80.00 10,800,000 $17,550,000

N.B. - This estimate does not include the many charities for which the service clubs provide "sustaining directors".

(d) Value of Service Activity to International Field
(now covering 145 countries) 2,000,000

(e) Government Tax Revenues from Provincial (or Regional) National and International Conventions
in Canada - Minimum Estimate

Illustration	International Convention	Year	Estimated Revenues	
(Based on	Kiwanis (Montreal	1972	$10 mill.	
performance	Optimist (Toronto)	1972	2.5 "	
bonds)	Lions (Windsor)	1973	10 "	
	Rotary	1975	10 "	3,000,000

(f) Estimated Cost to Government to Replace Donated Services using Government Personnel
13,500,000 man hours @ $6.00 $81,000,000

Estimated Additional Government Expenditure Required to Replace Service Club Activity per year in Canada -

$103.55 million

Ratio of Extimated Services to Canada by Service Clubs versus projected tax increase by disallowing expense deductions

$$-- \frac{103.55}{4.787} = 21.6:1$$

Comments

1. We have been purposely conservative in these estimates. It is expected that when our national survey is completed a much more meaningful picture will reveal itself to prove the "money leverage" generated by service clubs. No account whatever has been given to the bequests and foundations administered by Kiwanis and other clubs. One club alone has donated $228,998 to charities since January 1, 1960. (253 members).

2. Interestingly, approximately 85% of the membership strength of Canadian service clubs is located in communities outside the four major cities of Montreal, Toronto, Winnipeg and Vancouver. Legislation that negatively affects service clubs will hit the smaller centres hardest where social services are weakest.

3. It is realistic to expect a 1/3 decrease in service club memberships immediately if the present White Paper amendment is imposed to deny tax deductions to corporations, business firms and professional men for service club dues and luncheon expenses.

   If the energy of Canadian service clubs is worth $103 million per year, a 30% loss of membership would undoubtedly cause a short term loss per year of $31 million to the Government of Canada, the provinces and the local communities.

   The possible cumulative effect is even more serious. The Canadian service club movement may cease to exist as we know it if younger members are discouraged by tax penalties from developing the concept of community service and responsibility which has been such a rich Canadian tradition for the past 50 years.

   The proposed taxation policy encourages a philosophy "to leave things to the government" and to discourage voluntary initiative in the whole spectrum of cummunity needs.

Under our conditions of "cost push inflation", - to achieve comparable services to the Canadian community may well require $200 million of services by 1980 instead of the present Canadian service club ontribution which we estimate to be about $100 million per year.

It is one thing to collect $5 million of increased taxes. It is quite another to generate $100 million worth of civic energy per year that stimulates the life blood of this country by providing imaginative solutions to the social, cultural, political and economic life of Canada, at no governmental expense whatever.

Recognizing the practical truth of this situation and the relative values involved, it would seem prudent to suggest that the Tax Department should completely reverse its position on this aspect of the White Paper, and adopt an expense deduction policy that will encourage greater service club activity.

General Conclusions

A small increase in tax revenue may result in the short run if there is a restriction regarding the tax deductibility of service club dues and luncheon expenses.

This increase may be expected to decline sharply if service club memberships drop sharply.

This temporary financial advantage of a nominal sum proportionately is offset by:

-- Fewer persons to give free time to voluntary activities in the public service field.

-- Fewer money-raising activities on a voluntary basis, for smaller financial targets.

-- Greater dependence on government expenditure to provide replacement services in the areas of youth development, public education, social welfare, cultural activities, hospitals, homes for the aged, etc.

-- Less citizenship responsibility is likely to come from corporations.

-- Most important of all, fewer Canadians will be participating of their own free will to help bridge the gap between the new needs of our society in each community and the support that may be expected from our governments when these needs have matured to become political issues.

-- Regional and local needs will be much less flexibly resolved because of the rigidity of red tape -- government representation -- departmental budgetary limitations, and lack of voluntary community support.

-- This means the erosion of a basic tradition in the Canadian way of life, on a participatory basis.

The Kiwanis Club of Montreal and all clubs endorsing this submission are in support of the government's objective to create an equitable taxation system in Canada.

We respectfully ask, however, "Does it make good sense to raise $5,000,000 a year by denying deductibility of service club dues an and luncheons if this action could lead to a realistic cost of $30,000,000 a year in the short run and as much as $ 100,000,000 to $200,000,000 a year if service clubs cease to exist in 10 years' time?"

Respectfully submitted

J.R. Flumerfelt
Vice-President
Kiwanis Club of Montreal

Queen's Printer for Canada, Ottawa, 1970

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 27

WEDNESDAY, MAY 27th, 1970

Twenty-First Proceedings on the Government White Paper, entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 27:5)

APPENDICES:

"A"—Brief from The Canadian Manufacturers' Association.
"B"—Analysis of Appendix "A" by Senior Advisor.
"C"—Brief from Bell Canada.
"D"—Analysis of Appendix "C" by Senior Advisor.
"E"—Brief from The Canadian Chemical Producers' Association.
"F"—Analysis of Appendix "E" by Senior Advisor.

22087—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Desruisseaux	Kinley
Aseltine	Everett	Lang
Beaubien	Gélinas	Macnaughton
Benidickson	Giguère	Molson
Blois	Grosart	Phillips (*Rigaud*)
Burchill	Haig	Walker
Carter	Hayden	Welch
Choquette	Hays	White
Connolly (*Ottawa West*)	Hollett	Willis—(30)
Cook	Isnor	
Croll		

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

22087—1½

MINUTES OF PROCEEDINGS

WEDNESDAY, May 27th, 1970.
(41)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

"The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Benidickson, Burchill, Carter, Connolly (*Ottawa West*), Cook, Desruisseaux, Everett, Gelinas, Haig, Hays, Hollett, Isnor, Kinley, Macnaughton, Molson, Phillips (*Rigaud*) and Welch—(20).

Present, but not of the Committee: The Honourable Senators Methot, Sullivan and Urquhart—(3).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

WITNESSES:

Canadian Manufacturers' Association:

Mr. G. Bruck, President, Bruck Mills Ltd., Montreal. (Member, Executive Council);

Mr. K. O. Fowler, Texaco Canada Limited. Chairman, (CMA Subcommittee on Capital Gains);

Mr. G. C. Gibb, Canadian International Paper Co., Economist;

Mr. G. H. Hughes, Manager, Legislation & Taxation Departments; CMA;

Mr. D. H. Jupp, Ottawa Representative, CMA;

Mr. A. D. Laing, Dominion Foundries & Steel Limited, Chairman, CMA Taxation Committee;

Mr. J. Lees, Alcan Finances Limited, Chairman, CMA Subcommittee on International Income;

Mr. D. A. Macintyre, Imperial Oil Limited. Chairman, CMA Subcommittee on Corporations and Their Shareholders;

Mr. J. C. Whitelaw, Executive Vice-President, CMA;

Mr. N. Reed, Chairman, Toronto and District Branch, CMA.

Bell Canada:

Mr. G. C. Wallace, Vice-President—Finance;

Mr. G. L. Henthorn, Comptroller;

Mr. D. L. Robertson, Economist.

At 12:40 p.m. the Committee adjourned.

AFTERNOON SITTING

At 2:30 p.m. the Committee *resumed.* 2:30 p.m. (42)

Present: The Honourable Senators Aseltine, Beaubien, Benidickson, Burchill, Carter, Cook, Everett, Gelinas, Haig, Hays, Hollett, Isnor, Kinley, Macnaughton, Molson, Phillips (*Rigaud*), Welch and Willis—(18).

*The Honourable Senator Phillips (*Rigaud*) and the Honourable Senator Benidickson *Acting Chairmen.*

Present, but not of the Committee: The Honourable Senator Methot—(1).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

The Canadian Chemical Producers' Association:

Mr. C. S. Malone, President, Chemcell Limited;

Mr. B. F. Macdonald, President, The Canadian Chemical Producers' Association;

Mr. C. A. Brooke, Manager, Tax Department, Domtar Chemicals Limited;

Mr. D. A. Macintyre, Assistant Manager—Tax Compliance, Imperial Oil Limited.

Ordered: That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from The Canadian Manufacturers' Association.
B—Analysis of Appendix "A" by Senior Advisor.
C—Brief from Bell Canada.
D—Analysis of Appendix "C" by Senior Advisor.
E—Brief from The Canadian Chemical Producers' Association.
F—Analysis of Appendix "E" by Senior Advisor.

At 4:00 p.m. the Committee adjourned to the Call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, May 27, 1970.

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have three submissions today: the Canadian Manufacturers' Association, Bell Canada, and the Canadian Chemical Producers' Association. We have a large representation from the Canadian Manufacturers' Association, and Mr. Bruck is going to open the proceedings with a statement.

Mr. G. Bruck (President, Bruck Mills Ltd., Montreal), Member, Executive Council, Canadian Manufacturers' Association: Thank you, Mr. Chairman. I would like now to introduce the members of our delegation: Mr. A. D. Laing, Mr. D. A. Macintyre, Mr. K. O. Fowler, Mr. J. Lees, Mr. G. C. Gibb and Mr. N. C. Reed. Mr. Laing is chairman of the C.M.A. Tax Committee. This committee struck eight study groups to consider the various chapters of the White Paper and some of the chairmen of those study groups are with us today.

At the conclusion of my remarks I will be asking Mr. Laing to answer various questions the committee may wish to ask, or to indicate those members of our delegation who should do so. Our submission to this committee on the Government's White Paper on Taxation deals, as you would expect, with the Government's specific proposals and their possible economic effect. But it is appropriate in these opening remarks to deal also with the other side of fiscal policy—the spending of the revenue which these proposals would generate.

Total gogernment expenditures have steadily been increasing. In 1969, these expenditures amounted to 33.6 per cent of the gross national product and 44.1 per cent of net national income. As is well known, the Economic Council has predicted that by 1975 total expenditures will exceed 38 per cent of G.N.P.

The Association believes that this is a trend which is undesirable and which must be halted, and we are therefore concerned about the increased government revenues which the White Paper's proposals would generate.

Much of this expenditure will undoubtedly be on a variety of welfare plans, many of which in our opinion, are uncoordinated and are not significantly achieving their very desirable objective of eliminating poverty in Canada. We are, therefore, pleased to note that the Government is currently reviewing these plans and that a committee of the Senate is considering poverty in Canada.

There is no doubt that a tax system should enjoy the confidence and have the support of taxpayers. It must therefore aim at equity and we commend as achieving a greater degree of equity in the tax system the following White Paper's proposals:

> (1) The proposal to offer tax relief for people at the lower end of the income scale.
>
> (2) The proposal to allow employees to deduct expenses incurred in earning wages and salaries including deduction of contributions to unemployment insurance.
>
> (3) The proposal to allow a deduction for costs of looking after young children when both parents are working.
>
> (4) The proposal to allow a deduction for expenses taxpayers often must incur when they move from one job to another.
>
> (5) The proposal to establish a new depreciation class to provide for the deduction of capital expenditures which are not presently deductible and are sometimes called "nothings."

Having said all this, we must caution that a tax policy which searches for equity at the expense of economic growth is self-defeating. For it must be remembered that the poor, who are meant to benefit from greater equity, will be the first to suffer from slower business growth. That is not to say, of course, that

economic growth is a panacea for all social and economic ills. We do insist, however, that governments cannot provide any form of higher income without having real economic expansion as a base. Fiscal policy should be directed to this end. As we say in our submission

> The Association believes that top priority should be given to the objective of economic growth which goes hand in hand with improving the quality of life.

The Association is disappointed that the Government's proposals ignore consumption taxes. We believe that changes in the income tax system of the magnitude proposed in the White Paper should not be dealt with in isolation. The White Paper admits that our corporation income taxes are already high by international standards and that further increases would be damaging. We consider, therefore, that in the implementation of the tax reform measures resulting from consideration of the White Paper's proposals, the objective should be to produce an optimal mix of income and commodity taxes into a total tax package.

Mr. Chairman, if we were asked to pinpoint those five areas of the White Papers' proposals which we consider most important, our list would be something like this.

First, integration. While we endorse the White Paper's objective to "offer a substantial inducement for Canadians to invest in Canadian business," we do not consider the integration proposals achieve their expressed objectives any more adequately than the existing dividend tax credit. The integration proposals are extremely complex and present many difficulties and we therefore favour the retention and the increase of the dividend tax credit.

Second, incentives for small businesses. The Association agrees that the incentive of the low corporate tax rate need not be applied indiscriminately to all companies. We have considered the desirability of replacing the low rate of tax by other forms of incentives such as high capital cost allowance. However, in our opinion, the present low rate is a more efficient incentive for small businessses than the alternatives we have considered and we therefore favour the retention of the low rate on the first $35,000 of taxable income but only for those companies whose taxable income does not exceed, say, $250,000.

Third, capital gains tax. These proposals are interwoven with the integration proposals. In any event we are not convinced that a capital gains tax is desirable at this time in Canada. However, if such a tax does become appropriate then we suggest it should be imposed gradually in a separate rate schedule only on realized gains and at rates much below those presently proposed.

Fourth, co-ordination with the provinces. This must be the crux of the White Paper. If, for example, the provinces increased their personal income tax rates and these rates exceeded the assumed rates in the White Paper, we have a very different tax reform package. This is important at a time when provincial revenue needs are so great.

Fifth, economic impact. The White Paper does not, in our opinion, adequately deal with this matter. We are convinced that the White Paper's proposals would depress the potential rate of growth in production and employment.

Mr. Chairman, we are grateful of this opportunity to appear before you and answer such questions as the committee may care to ask. I conclude by repeating this statement from our submission:

> The CMA recognizes the White Paper as the Government's contribution to the ongoing public debate about tax reform. By issuing a document for discussion and review rather than a Bill for legislative action, the Government has made a commendable decision which the Association warmly applauds.

I will now ask Mr. Laing to receive your questions.

Senator Phillips (Rigaud): Mr. Chairman, may I just put one question before Mr. Laing proceeds? Would you be good enough to tell us how many manufacturers are members of your association and how long your association has been in existence? Roughly what is the size of your association in terms of importance economically in the country and in terms of sales and so forth? In other words, do you represent all of the leading manufacturers of the country, from the largest to more or less the smallest?

Mr. Bruck: Senator Phillips, I would say yes, emphatically, we do represent most, if not all, of the leading manufacturers of this country. We have over 5,000 manufacturing companies in our membership, with over 7,700 accredited representatives. We estimate that 70 per cent of our members have fewer

than 100 employees and that 91 per cent have fewer than 500 employees.

Senator Phillips (Rigaud): Thank you. I thought that would be useful as a background.

The Chairman: Mr. Laing, if you are not wedded to any particular order in presenting your various points, would you deal first with small businesses? I am particularly interested in knowing how you arrived at a figure of taxable income on net profits of $250,000 as being the proper term to use for a definition of small businesses. You will appreciate that we must define small businesses before we can apply a special rate.

Senator Benidickson: We have had figures given to us based on sales and so on.

The Chairman: Yes. A witness from the Canadian Chamber of Commerce said that in his merchandising business the volume of sales to generate $250,000 would be so substantial that you could not call his business a small business.

Mr. A. D. Laing (Dominion Foundries and Steel Limited), Chairman, CMA Taxation Committee: Mr. Chairman, may I ask Mr. Macintyre to speak to the specific point of how he arrived at the $250,000 figure?

Mr. D. A. Macintyre (Imperial oil Limited), Chairman, CMA Subcommittee on Corporations and their shareholders: Mr. Chairman, there are a variety of ways by which one can measure size. For example, how long is a piece of string?

The $250,000 figure referred to in our brief was arrived at somewhat arbitrarily because at that level the tax increase represented by the removal of the low corporate rate on the first $35,000 represented a tax increase in the order of 10 per cent rather than a tax increase of 140 per cent or 150 per cent that would apply to a corporation earning $35,000. It was chosen primarily as a level at which the removal of the low rate would not have a significant impact on the small corporations.

The Chairman: Why do you say it would have no significant impact? Any business earning up to $35,000 pays 21 per cent. If you split businesses in such a way that what you call small businesses continue to enjoy the 21 per cent, you have not at that moment reduced the tax revenues at all. In fact, by taking the 21 per cent rate away from the businesses that are not small you increase the tax revenues.

Mr. Macintyre: That is correct, senator.

Mr. Chairman: Is your suggestion to the effect that something should be done in the area between $35,000 and a tentative breaking point of $250,000? If you have a net profit or taxable income of any amount up to $250,000, the benefit you receive is 21 per cent on the first $35,000 and the rest of your taxable income is subject to the going corporate rate of 50 per cent.

Mr. Macintyre: That is correct.

The Chairman: You have nothing in the form of a notch provision?

Mr. Macintyre: Perhaps when the details are gotten down to a notch might be desirable. We smoothed out somewhat the requirement for a notch by recommending that the low rate not be removed until taxable income had exceeded $250,000 on average for a three-year period.

The Chairman: The notch would lessen the tax revenues, you realize.

Mr. Macintyre: Yes.

The Chairman: Do you think there is merit in having a notch provision, then? Obviously there is merit from the point of view of the small businessman who would pay less tax, but, adopting an objective approach to the whole question and looking at the need for tax revenues, what is your opinion?

Mr. Macintyre: If the $250,000 limit were in effect and the low rate did not drop out until $250,000 income had been exceeded for three years in a row, then probably the need for a notch would not be too great. If, however, as others have suggested here, the low rate were to be cut out at an even lower rate on the achievement of a particular arbitrary level of income, it might well be that a notch would be necessary.

The Chairman: Many of the people appearing before us have given clear statements that the best way to define small businesses would be by reference to the net profit or the taxable income of the business. We have explored with the various witnesses all of the other avenues: capital income, sales volume and so on, realizing that the Small Business Loans Act identifies the small businesses on the basis of volumes of sales, and I would say that the consensus of opinion would appear to be that the taxable income base is the clearest and the best base. So far as the amount of

that base is concerned, we have had suggestions ranging anywhere from $60,000 to $100,000. I do not think anyone has suggested an amount over $100,000, and the witnesses we have had before us included the Retail Hardware Merchants Association, the Retail Council of Canada, and I think we even got a statement from the Canadian Chamber of Commerce. I would say the consensus there would appear to be anywhere in the area between $75,000 and $100,000. Do you think that that is a fair limitation for a definition of a small business?

Mr. Laing: Without repeating our position, one of the problems we are looking at is this; when there is reform, there are changes, and we think the change that is not too exaggerated is likely to be least harmful. I think we would have to agree that you could pick any figure from the point of view of net income less than $250,000. That could be justified, we think. Our reason for suggesting $250,000 is that it results in a change which is least likely to be harmful at that level. At the $75,000 level, in my opinion, it would be a significant change for a company to have its tax bill changed quite a bit in relation to that $75,000 income as compared to the type of change you would have with $250,000.

The Chairman: By change you mean to lose the lower rate at such a figure of taxable income?

Mr. Laing: That is right.

The Chairman: Of course, as you move up the scale, you remove the objection you have stated. You see, the amount of income that this 21 per cent on the first $35,000 has produced from small business has been of the order of, and we have had figures to this effect, $450 million. And the major portion of the tax revenues that the 21 per cent rate produced or produces at the present time is most substantially from small business and much, much less from large business. Now, how do you account for that?

Mr. Laing: The figure we were using as a reference was the additional income expected to be produced by the White Paper—about $390 million.

The Chairman: Of course that is in the fifth year.

Mr. Laing: In the fifth year. Now, we do have adequate statistical information to satisfy ourselves on the basis of our proposal while saying that some small businesses should retain it but larger businesses can forego that advantage. We have not been able to say that on the basis of our suggestion that would still result in one-third of that $390 million increase. I regret that we cannot give you a good estimate on that, but we think it does need some additional increased revenues to the Government.

The Chairman: Well, I suppose this is so obvious here that I hardly need to state it, but if substantial income or the substantial income from tax revenue is generated from the small business at the present time, then we are not changing that. We are only increasing the tax revenues by taking to the extent that we take it away from big business.

Mr. Laing: That is right.

The Chairman: And it would seem to be perhaps an excellent place to provide some leeway for a reduced invididual tax rate in the area from, say, $9,000 to maybe $24,000, where the rates really are increased very substantially. In other words, if the Government retained this revenue, maybe they would not need as much revenue from that class of individual tax payer.

Mr. Laing: We could not agree with you more. That is one of our concerns that so far as the middle income group is concerned part of the additional revenues that is looked for in the White Paper proposals is expected to come by the changes in that personal income tax rate and this happens to fall, unfortunately, on that middle income group.

The Chairman: Mr. Gilmour, do you want to add something on this point? You have prepared a study on this.

Mr. Arthur W. Gilmour, senior adviser: Could you give me five minutes?

The Chairman: Yes, when you are ready.

Senator Phillips (Rigaud): In dealing with small businesses, would you consider it desirable that the low rate be given not only to corporations, but to individuals and partnerships engaged in business only in so far as the lower rate would apply to the profit on the commercial operation as distinct from investment and other sources of income?

Mr. Laing: Yes, that is our opinion. We have done it in our brief in a way that may not be crystal clear. The idea is that a part-

nership type of situation is, we think, a useful kind of option.

Senator Phillips (Rigaud): In other words, a small business from the point of view of the lower rate should include individuals and partnerships as well as corporations.

Mr. Laing: We have not dealt with it in that way, Senator Phillips.

Senator Phillips (Rigaud): Do you think it would be equitable to do so? In other words, if you are talking of small businesses, should we confine the so-called privilege of reduced rate to corporations only and not include individuals or businesses, because if we get away from integration under the White Paper, we have to give consideration to that problem.

Mr. Laing: For small businesses, there are different types of arrangements that could be worked. Someone has suggested higher capital cost allowances or accelerated cost allowances, but others have said that this does not apply to situations where there is relatively little capital investment but where there is perhaps a large inventory. So maybe there is a way with respect to the inventory used by a business whether incorporated or unincorporated.

The Chairman: You will agree that the ideal thing would be to have the simplest form in which you could put this for administrative purposes.

Mr. Laing: Oh, yes, that is quite important.

Senator Phillips (Rigaud): But you would not regard it as inequitable or undesirable if the lower rate were applicable to corporations up to $35,000 and that the same principle should apply to individuals and partnerships?

Mr. Laing: We would agree with that proposition, yes.

The Chairman: Could we take it one step further along the lines suggested in the White Paper, and that is to have a partnership option, and it may be that a small business which is incorporated would be better off if it had a partnership option. That is to say it is incorporated, but it has an option under the White Paper of electing to be taxed on a partnership basis on the individual rates of the members rather than on the 21 per cent. Now conceivably there are a lot of small businesses who are in the category of having from $10,000 to $15,000 taxable income, and if you had such a business incorporated and you had three or four members in it, conceivably their marginal rate overall might be less than 21 per cent. I am just wondering if the idea of providing a partnership option might be of some value.

Mr. Macintyre: I think our brief endorses, Mr. Chairman, the option availability of the partnership election and I do not think we addressed ourselves to providing the low corporate rate to unincorporated businesses.

Senator Phillips (Rigaud): I know you did not, and that is why I put the question.

Mr. Macintyre: I do not think we considered it adequately. My immediate reaction is that it might be an area of fruitful abuse and difficulty of enforcement and definition. But that is not to say that something could not be worked out. Our brief does speak to one of the justifications in the White Paper for the removal of the lower rate. The White Paper implies that it is inequitable to provide the low rate for an incorporated business whereas the unincorporated business does not enjoy that low rate. Aside from gentlemen in the legal and accounting professions and the other professions that cannot incorporate, we think this is largely a fallacious argument because anyone who is at an income level where incorporation would be advantageous, is quite free to incorporate.

The Chairman: Yes, but my thought was running along this line; the White Paper really provides a fictional basis. The partnership option is a fictional basis for an incorporated company. What they say is that you just assume. You proceed on the partnership basis, but it is an incorporated company, so that is your first fiction. The shareholders in the small business may elect to be taxed as partners. That is fictional. The second thing they say is that the business can pay the tax, and it is not treated as income for the shareholders then. In other words, this is the fiction of the White Paper.

Now, why cannot we have a fiction doing it the way we were talking about—that is, that a non-incorporated small business can fictionally be taxed in sum total at 21 per cent, and that means that the members of that partnership have paid their personal tax. They are only taxable once. Surely, alternative proposals are entitled to have fictional aspects, the same as the White Paper?

Mr. J. Lees (Alcan Finances Limited), Chairman, CMA Subcommittee on Interna-

tional Income: We discussed some of this in our committee, and some of us were trying to take quite seriously the point raised in the White Paper that people psychologically think of the low rate of tax as somehow their money, whereas the White Paper sort of thought it was a Government loan to you, a privilege which you had to pay back, but when you paid dividends on the corporation. We discussed at considerable length this problem that there is a corporate bill, there is something there and the shareholder or the owner of the business has to do something to get the money out of his corporation and into his personal pocket, where he can spend it on consumer spending.

I think the consensus of our committee was that when a man withdraws money from his business for personal expenditure he should pay personal tax on it at graduated rates. There was a general feeling, although we had some dispute as to whether the small businessman should be given an extra incentive shot, a form of tax system which gives him a preferred rate of tax, if you will, because he runs a small business, even after he draws the money out as a dividend. We have accepted in the CMA brief that this system tends, to some degree, to give the small businessman a little better break than the fellow drawing the same net income on salary. We accepted that, but our problem was we took the suggestion you raised senator, that if you could put a fixed rate of 21 per cent on a $35,000 income from a hardware store, you would have the devil's own time trying to figure out how to get the graduated rate structure when he takes the money out of his hardware store and spends if on himself.

Senator Phillips (Rigaud): What difference does it make? First of all, you never quite know whether he does or not, because the whole conception of protecting small businesses is to allow them to build up the necessary capital for expansion—there have been some figures on this—and to have a climate of incentive.

Mr. Lees: And so long as the money is left in the business, no one cares.

Senator Phillips (Rigaud): In any event, with the consent of the Chairman, because we have many other points to consider, you do not consider it objectionable, as a matter of principle, that this committee should consider applying the lower rate not only to corporations but also to individuals or partnerships to the extent of their commercial profits of the business.

Mr. Lees: My recollection of our committee discussions is that there would be some objection.

Senator Phillips (Rigaud): That there would be some objection?

Mr. Lees: Yes, but surely our committee discussed this at great length, and I think some of us would have some reservations about it.

Senator Phillips (Rigaud): Is that the view of your colleagues with you?

Mr. Macintyre: I would have to agree with Mr. Lees.

Mr. Laing: I am sorry to dissent, but I think it is something that should be explored.

The Chairman: Mr. Gilmour is ready to give us some information on those figures we were talking about.

Mr. Gilmour: Gentlemen, to put the tax on the low companies into perspective and to consider the very interesting suggestion our guests have made this morning, as you know our present tax act says that every corporate taxpayer, no matter the size of its income, pays a two-tier rate of tax. The first $35,000 of taxable income bears tax at 21.3 per cent. Then any taxable income in excess of $35,000 bears the normal tax rate, which is roughly 52.3 per cent at the moment, taking into account the provincial taxes. That applies whether you are a company like International Nickel or "John Smith Incorporated," a very small company.

You will also recall that the Minister of Finance released to us some statistics on corporations, and they are incomplete statistics but they are the best we could get, and they showed that in Canada there are somewhat less than 100,000 tax-paying corporations, that something like 85,000 of this total have taxable income of less than $35,000, and that around 10,000 corporations have taxable income in excess of the $35,000. We could not get a breakdown of these 10,000 corporations. All we could find was that the average taxable income of the 10,000 corporations was about $430,000, which means that you would have a range from, at the bottom, $35,000 anywhere up to $35 million.

It is against that background that the committee is trying to determine what is a fair

definition of a small corporation. I think it has been felt that the definition should be based on annual taxable income. In other words, you could have the case of a very large corporation whose taxable income could swing tremendously from year to year but yet, for simplicity, it would seem that the definition of a large and a small business could be determined on the actual annual taxable income of that corporation, without regard to what it might have been the year before or the year after.

In trying to find what is a fair definition of a small corporation based on taxable income, I think these figures which I just jotted down might be of interest. If a corporation had taxable income of $100,000, the tax it would pay today, to the nearest hundreds, would be $42,000. Under the White Paper Proposals on integration that company with a taxable income of $100,000 will pay $52,400.

When we move up to $150,000 we find that the present tax is $67,100, while the tax proposed by the White Paper is $77,400.

At the level of $200,000 the present tax is $93,100, and it would jump to $103,400.

The last figure I have taken is $250,000, to which our guests referred. The present tax is $115,100, and the tax under the White Paper Proposals would be $125,400.

The problem that faces fair-minded members is: At what point does this extra $10,300 of tax proposed by the White Paper become significant. Mr. Laing has explained that after their studies they feel that a taxable income of $250,000 is the point at which the increase of $10,000 on top of the existing tax of $115,000 becomes significant. I think that is what you said, Mr. Laing.

Mr. Laing: Yes.

Mr. Gilmour: I merely wonder whether the breaking point of $250,000 may not be just a little high, because looking at a taxable income of $100,000 we see that the present tax is $42,100, while the White Paper tax would be $52,400, which means there would be a 25 per cent increase. When we get up to the level of $250,000 we have a base of $115,100, and then another $10,000 on top of that. Now, the increase becomes significant at some point between those two levels. I certainly think the 25 per cent increase hurts a company whose income is merely $100,000.

Perhaps if I place these figures on your record, Mr. Chairman, they will be of some help.

The Chairman: Thank you.

Mr. Gilmour: The figures are as follows:

Taxable Income	Present Tax	Proposed Tax
$100,000	$ 42,100	$ 52,400
150,000	67,100	77,400
200,000	93,100	103,400
250,000	115,100	125,400

The Chairman: Are there any other questions on this topic of small business?

Senator Carter: What is the total revenue that this will bring in from small business?

The Chairman: Yes. Have you your study paper on that?

Mr. Gilmour: No, I am sorry, I have not. It is in one of the study papers I have presented to you.

The Chairman: It is Study No. 5.

Mr. Laing: We were using the figures just cited of the 10,000 businesses with incomes over $35,000—I think that was the figure used—and if each of those paid $10,000 more in tax our guess is that the additional revenue that would be provided would be $100 million.

Mr. Gilmour: May I interrupt?

The Chairman: Yes.

Mr. Gilmour: No, Mr. Laing. There are about 80,000 companies with incomes below $35,000. Those incomes range anywhere from zero up to $35,000. Now, obviously the top 10,000 companies would each pay $10,300 more in tax, so the total would be $10,300 multiplied by 10,000, roughly. It is in that area that you would have an increased tax collection, but in the lower areas we have to make a breakdown of the companies that run from zero up to—well, I think the first range was up to $3,000.

Mr. Laing: May I try again? What we are getting at is that there is an additional revenue of $390 million looked for. What we are saying is, on the basis of the C.M.A. proposal, that the low rate on the first $35,000 be eliminated for those companies with incomes over $35,000, and then we think, on the figures, that there would be 10,000 businesses each of which would be paying $10,300 more tax.

Mr. Gilmour: Of course, the 10,000 businesses have incomes ranging from $35,000 up. There would be a big proportion of those

10,000 businesses which would lie between the income range of $35,000, and, say, $250,000.

Mr. Laing: Yes, quite.

Mr. Gilmour: And we do not have the figures. All we could say is that under the White Paper proposals it was the little fellow who is making less than $35,000 who is getting badly hit, and we can measure accurately—and we did—just how badly he is hurt, but then our statistics stopped at $35,000.

Mr. Laing: Yes, the only measure we have of that is that their average is about $430,000, and you cannot predict from that.

Mr. Gilmour: That is right.

The Chairman: We do have some studies on this, Mr. Laing. An auditing firm from Montreal made their own analysis and came here to give us the benefit of it. They are now making a comparison between Mr. Gilmour's Study No. 5 and their figures. Their figures were pretty close to the figures Mr. Gilmour's study produced as to what the impact would be on small business. Certainly the substantial part of the increased tax revenue, if the White Paper proposal is implemented, would come from small business.

Mr. Laing: Yes.

The Chairman: Are there any questions on small business? Shall we move on to the moot question of integration?

Senator Phillips (Rigaud): I think, Mr. Chairman, we had interrupted Mr. Laing to supplement Mr. Bruck's remarks dealing with small business. Should we not now deal with the headings as they wish?

Mr. Laing: It is my understsanding that we deal with the headings as we wish.

The Chairman: Yes.

Senator Phillips (Rigaud): Then I have a question to put, Mr. Chairman. I find that this brief is one of the first to emphasize a point that I have been trying to emphasize for some time, and that is that the implementation of the proposals in the White Paper is conditional upon agreement with the provinces, although the White Paper says so implicitly. I am referring to Chapter 7 which is headed "Co-ordination with the Provinces", and to paragraph 7.1. In paragraphs 7.20 and 7.21, under the subheading of "Timing and Parallel Action", we have an indication there as to the timing.

In view of the fact that the provinces at the moment do not seem to indicate what I would call any particular affection—and certainly not a love affair—with the whole concept of the White Paper and its possible implementation, and on the assumption that the Government will be concerned about that fact and will not want to implement the fundamentals of the White Paper in terms of the concept of integration and the like until there is agreement with the provinces—this is my assumption—what aspects of the White Paper do you consider capable of implementation at the present time? Mr. Bruck has touched on one, the treatment of small businesses, and also the elimination of taxation and its application to the lower income tax brackets. Are there any other suggestions or substantive thoughts in the White Paper which you think should be the subject of current thinking by the Government at the present time in order to grant relief to the two segments of the economy which need it?

Mr. Lees: There is one of foreign income. We have made the suggestion that if someone is upset about people leaving the country with their income, section 64, dealing with personal companies, could be strengthened and some clauses added. This would deal with the problem described in the international section where a Canadian buys a $1,000 bond and sends it to a company which he holds incorporated in the Bahamas.

The existing legislation is weak and difficult to enforce in this area. Conceivably something could be done to add more teeth and reporting requirements to oblige people to disclose this type of transaction.

This is one area where the highly touted reform could take place without harassing the on-going of our commercial and business establishments.

Senator Phillips (Rigaud): Do you think the present provisions of the Income Tax Act covering avoidance and minimum wages are a sufficient instrument?

Mr. Lees: Personally I would have thought they were sufficient. However, I am told there is difficulty under existing law because people form corporations with elaborate share structures.

Mr. Laing: Could I mention a few other areas where we think something should be

done? These are largely in the personal income tax area.

The deduction with respect to expenses in connection with earning employment income could be looked at separately. The proposal with respect to child care allowances is one that could be dealt with. The proposal for a new depreciation class is another that I think should be fitted into the present arrangements.

The other area that could be considered now, of course, is the commodity or sales tax. With respect to the international aspect, to some extent there is mention of companies with thin capitalization. In other words, very low capital and substantial debt.

Senator Phillips (Rigaud): What is your justification and reason for the suggestion that the increase of the dividend tax credit should go up from 20 per cent to 25 per cent? You regard this as being a useful instrument to more or less bring about an integration of justice, rather than using integration under the White Paper.

Is that merely a thought, or is it based upon a line of reasoning?

Mr. Macintyre: Our feeling is that there is a general feeling within the country that Canadians do not have sufficient incentive to invest at the present time. If it is desired to increase that incentive, an enlargement of the dividend tax credit would seem to accomplish it without the many attendant complications involved in the integration proposals as outlined in the White Paper.

Senator Phillips (Rigaud): One speaks *sotto voce* these days about unemployment, recessions or a transient period of uncertainty so as not to create a furore, but would you gentlemen consider that this climate of unemployment and transient uncertainty is a proper one in which we should consider a revolutionary system to change the taxing laws of our country?

Mr. Laing: At the moment our concern is highlighted from the point of view of the problem with any new scheme, that it accomplish something without destroying or disrupting to too great an extent.

Many of our companies expect markets to increase in the future. We have to raise new capital to be able to serve those markets. The stock market these days is in such a state that it does not seem to be an encouraging place to find new funds.

If in addition to the current malaise in the stock market a new scheme of this nature, the effects of which on the securities markets we consider to be unpredictable, were introduced it would be most unfortunate at this time.

Senator Phillips (Rigaud): As part of the same theme, there are certain well-meaning citizens of this country, as well as persons in authority, who think that all the briefs that we receive are simply the cry of pain of people who will be called upon to pay more taxes, rather than less.

I would like to ask a responsible organization such as yours whether it is your considered opinion, as leaders of industry in the manufacturing segment that, broadly speaking, the proposed changes reflected in the White Paper are unsettling to the economy of the country?

Is that your truthful, sincere opinion as good Canadians, or are you here as representatives of industry, trying to avoid increased taxes, minimization and that sort of thing?

Mr. Laing: I do not like to deal lightly with such a basic and fundamental question.

Our concern in considering the White Paper was twofold. One, having experience with income tax and how it affects a great variety of companies throughout the country, we have certainly taken those technical aspects into account.

The other aspect which concerns the organization is that it represents manufacturers and we have had particular reference to the effect of the proposals on manufacturers, who are a broad group.

The third consideration, which we hope we never lose sight of, is that we feel some responsibility. This becomes partly personal, but I think I can speak for people I have known in CMA who feel responsibility in coming forward with comments, recommendations or criticisms, to try to take the welfare of the country as a whole, and not only our own special interests, into account.

Senator Burchill: You gentlemen represent a body of opinion of manufacturers right across the nation. You have studied this White Paper. I may have missed this in your brief, but was there any consideration given in your study to the fact that these changes are too violent and drastic? Do you consider that it would be much better to achieve the objects of equity and improvement that you have pointed out if these suggestions had been worked in gradually, rather than an attempt made to digest them all on one plate? Has that thought been expressed at all? I have heard it across the nation.

Mr. Laing: It has not been explicit in our brief. I do not think we addressed ourselves to that point. There are two obvious problems. One is, if it is expected that the Government at this stage will receive the reports of this committee and the other committee and be able to take them into account, then draft legislation and have it ready to be implemented in 1971, which I believe is the target date, it is hard for me to understand how that can be done within that time limit. The second major aspect, and where we are concerned, is that we do not think the federal Government can deal in isolation; there are other governments they have to deal with in order to come up with legislation that will be acceptable across the country.

Those are the concerns we have had. Part of this aspect is that if changes are to be made, transitional provisions are useful. There are some in here, but our concern is rather that instead of just transitional provisions, possibly instead of trying one great related coherent package at one time individual aspects could perhaps be dealt with one at a time in a more gradual and progressive way.

Senator Macnaughton: I have two questions. The first concerns co-ordination with the provinces, which has been pretty well self-evident here, both in the brief and in the discussion this morning. I should like to call attention to paragraph 17 on page 4 of your brief, "International Income", which is dealt with quite extensively on pages 26 to 30 inclusive. In particular, paragraph 17 says:

> The capital gains and withholding tax proposals would reduce the attractiveness of investment by non-residents in Canada.

Could someone expand on that a little?

Mr. Lees: With respect to the capital gains tax proposals, as you know, it is suggested in the White Paper that foreign corporations owning all the shares of the wholly owned subsidiary of a closely held Canadian company, a subsidiary—they may not own all of it, but there would be a subsidiary company—would, if they sell their interest in this company, be subject to Canadian tax, or at least Canada would in its statute try to impose such a tax. International tax agreements and tax treaties would have a great deal to say on whether that obligation to pay tax is nullified by the treaty or whether it comes in effect. Surely foreigners electing to invest and make a direct investment in Canada in the form of a subsidiary company would mark that down as a negative, a discounting factor in their investment.

This tax as we see it would apply, not only should that foreign corporation sell to another foreign corporation, but also if it sold it back to Canadian interests. To collect taxes, to enforce taxes, to obtain credits in your home country against such a tax, should Canada impose it, gets people into an area where the law is unknown, and it is just a large discount, it is a bad fact feature.

The second point concerns withholding taxes. When we raise the basic rate to 25 per cent on, generally speaking, all forms of distribution from Canada, and then ask that this rate be brought down to a more modest figure by international agreements and tax treaties, it fundamentally depends upon Canada being able to negotiate all these tax treaties with all the countries from which the capital will originate. To have these tax treaties means that Canada must negotiate all of the international ramifications in the White Paper. People will be uncertain whether these negotiations will be successful. Certainly there is considerable investment capital in this country today from countries that do not have tax treaties with Canada to date. I would mention Switzerland and Italy as two examples. These people will be very nervous about their continued relationship and a 25 per cent withholding tax, and, since they must have a tax treaty, whether they can negotiate one. I think there will be a sort of pause in their investment attitude towards Canada until they see the outcome. I think this is the sense of our statement.

Senator Macnaughton: That is set out reasonably well in paragraph 150 of your brief, dealing with foreign tax credit. In other words, you say, in effect that foreign investors will certainly pause, and there are other countries they could invest in?

Mr. Lees: Yes, sir.

Senator Macnaughton: Is that the tenor of your remarks.

Mr. Lees: Yes, sir.

The Chairman: We heard from Massey-Ferguson a week or so ago. They are in the category of a multi-national company, with the chief company centered in Canada and operating companies in various parts of the world, including developing countries, where they may enjoy particular tax incentives, but

where the law or custom of the country requires a national character to the operation in that country. They had two propositions. One was that the proposals in the White Paper militate against a multi-national company being located with its headquarters in Canada, because with the dividends or income coming in from all these outside operations there would not be a flow through of creditable tax, and therefore the penalty on bringing that income home would be too great. That was one proposition.

The second proposition they put to us and seemed to support was that it would encourage the setting up or maintaining of subsidiary companies in Canada rather than having the main operation of a multi-national company in Canada. I gathered from some things you said that you may not be in agreement with the second proposition.

Mr. Lees: I guess we are searching for the truth, and universal condemnation does not get us anywhere. I think the White Paper deserves very high marks on the flow-through mechanism for foreign withholding tax. I do not have the White Paper in front of me, but in the section dealing with international income there is a chapter on flow-through. It is very difficult to understand, said in very few words, but this particular device for that kind of a multi-national company, which obtains substantial sums of revenue in the form of foreign dividends...

Senator Phillips (Rigaud): Would that be 71?

The Chairman: It is on page 75.

Mr. Lees: Paragraph 6.27 on page 75. This is very complex and sophisticated, and is one of the novelties in the White Paper that gives us some trouble in other areas. The basic feature of this...

The Chairman: You misunderstood me. They were not talking about withholding tax; they were talking about the earnings of a foreign subsidiary coming through in the form of dividends for the Canadian company; the full amount of the dividend would be income and subject to corporative taxation in Canada under the White Paper.

Mr. Lees: We must define a multi-national corporation then. To my mind, a multi-national corporation is one that has its share ownership widely diversified in many countries. It is not a mainly Canadian owned company. Its operations are in turn widely held round the world.

The Chairman: Let us define our terms. I gave you the illustration of Massey-Ferguson. They have their main or number one company in Canada, which is a combination of holding and operating. They own shares of subsidiary companies in various parts of the world. That is the base. Then, in many of those countries they earn moneys and they pay dividends to the Canadian company. I am not talking about withholding tax, but under the White Paper when the dividends come through from the Canadian company they would be taxed at the full corporate rate and there would be no creditable tax.

Mr. Lees: I work for Alcan Aluminum. Our situation is somewhat different. I think that the type of story which Massey-Ferguson describes will be true. Some multi-national companies will find, particularly for their Canadian residence shareholders, that the system will not work as well as the present one. Others will find that the system is equally good or superior and will become more superior because of this flow-through business.

The Chairman: That is only in relation to withholding tax.

Mr. Lees: This is what obtains the tax credit for the Canadian resident. If the mass of your dividends are coming from companies which have tax treaties with Canada there will be no tax on income at the corporate level. This withholding tax flow-through plus the generation of taxable income in Canadian factories and plants tell the results to your Canadian shareholders.

The Chairman: Your assumption is that tax treaties will take care of a situation of that kind?

Mr. Lees: This is the presumption of the White Paper, and the answer is yes.

The Chairman: Just pause for a moment and think about a growing or developing country which has special tax incentives. Is it likely to be ready to make a tax treaty with Canada? Who can it make a tax treaty with?

Mr. Lees: The truth is that the Norwegians, Germans and Swedes do very well writing tax treaties because they give the developing countries exemption on dividends. I think this is what France has in mind, because they are

going to write very generous tax treaties with these people.

Our difficulty is that we are writing tax treaties with developed countries where we already may have a treaty to be amended. Canada wants to talk about taxing capital gains and pensions and a lot of things in which we are going to have difficulties. If you step aside from the area of the White Paper to the practical problem of getting a lot of tax treaties within four years, we say that the White Paper bites off more than it can chew.

The Chairman: At the present time do we have any tax treaties with any South American countries?

Mr. Lees: I do not believe so.

The Chairman: And I suppose the very reasons that have militated against the making of tax treaties may continue to exist so far as South American countries are concerned.

Mr. Lees: Well, six months ago I was strongly of that view. Now I find that Norway and Germany seem to have made treaties with Brazil, and France just made a treaty with India. I did not know those countries would even make tax treaties. It has to be pretty well based on give-away terms.

Senator Everett: Coming back to the question of integration, you say in clause 12 that you disagree with the White Paper's proposal to integrate. You propose that the tax dividend credit should be raised from 20 to 25 per cent. You go on in clause 22 to say:

> It is well known that for all practical purposes evasion of tax made possible by surplus stripping and spreading corporate income through a series of companies to get the lower rate is no longer possible because of the provisions of section 138A of the Income Tax Act.

In item 1.48 of the White Paper the department deals with the problem of a closely-held corporation paying some 50 per cent tax on its income and then retaining that income because of the incidence of additional tax, getting it out into the shareholders hands. One of the proposals of the White Paper is that income accrued up to valuation date shall be distributable on the payment of a flat 15 per cent tax. After valuation date there would be total integration, the idea being that the shareholder of the closely held company would be induced to take the money out of the corporation.

On page 19 you show the effect of the tax dividend credit on a taxpayer whose marginal rate is 50 per cent, which is akin to the top marginal rate in the White Paper. It shows, in getting out that additional income or surplus from the closely held corporation, that the taxpayer will pay an additional tax of $30 on each $100.

I wonder, Mr. Laing, if you could tell me what in your proposals is going to get us away from the lock-in effect of your surpluses in closely held corporations?

The Chairman: Under what circumstances, under the White Paper or without the White Paper?

Senator Everett: Under the proposals of the C.M.A.

Mr. Macintyre: Senator Everett, although there were complaints a few years ago about the lock-in affect of existing surplus in corporation rates considering the over-all interrelated package proposed by the White Paper, the existing and, I assume, legal methods of extracting surplus from existing companies is under section 105 at the 16⅔ per cent and 20 per cent. I think these are becoming relatively more attractive now as against the alternative of the total interrelated consequences of the White Paper.

Senator Everett: So you are suggesting that a tax of the 105 variety for the distribution of corporate surplus; is that correct?

Mr. Macintyre: Yes.

Senator Everett: Have you given any thought as to the amount of the tax or how it should be paid and how the distribution should take place?

Mr. Macintyre: I do not believe we have considered that in detail, senator, no.

The Chairman: Senator Everett, while we are on that very point, could we have a clarifying statement from Mr. Gilmour?

Mr. Gilmour: Senator Everett, with respect to starting up a system and the taxation of the existing surpluses of closely-held companies, you quoted in part from paragraph 4.78 of the White Paper. That paragraph is one of the delightfully ambiguous sections of the White Paper; when you study it, suddenly what it means starts to scare the dickens out of you. Just quoting from the second sentence of paragraph 4.78, it reads:

> As the earnings accumulated before the new system begins—"undistributed

> income on hand" to use the technical phrase—are distributed, a special 15-percent tax would be levied.

Which is what you have said.

> The distribution would then be considered as a return of capital to the shareholders, offsetting part of the cost or beginning value of their shares.

And I skip a bit.

> Corporations could elect to treat early distributions as being of this nature and so clear up their situation.

What I interpret that gibberish to mean is that if you have a closely-held corporation with a good piece of accumulated undistributed income—as a good many such companies have—your undistributed income at the start of the new system, assuming it starts, would first be subject to 15 per cent tax. Then the distribution admittedly would not be subject to further tax at the moment, but it would then reduce the value of the shares of the closely-held corporation and at some later date when the shares were sold or liquidated for break-up value, you would then find you were being subjected to capital gains tax, in effect, on the undistributed income, or 85 per cent of it, at the full 50 per cent rate. So it means that instead of the White Paper helping the closely-held corporations, it is hitting them a terrible blow below the belt.

So this provision as it applies to the start-up of integration is most horrible because it hits you on both flanks. Perhaps not immediately, but it could put the closely-held corporation into bankruptcy.

Senator Everett: In other words, the definition in the White Paper of undistributed income might be entirely different from that under the present act so that this could impose a 15 per cent tax on corporate surpluses that are not taxed under the present Income Tax Act.

Mr. Gilmour: It could very easily be that undistributed income could have a broader meaning than it has today. Today undistributed income merely means your tax profits—the taxable income less income taxes accumulated since 1917. It does not include accumulations of capital surplus.

Senator Everett: That is what I was referring to, yes.

Mr. Gilmour: But again, the inference to be drawn from the White Paper is that if a closely-held corporation today has an accumulation of what we would call a capital surplus, or an untaxed surplus, the direct inference is that there will be a 50 per cent tax levied on what today is a tax-free accumulation. The message that it carries is that if you have a closely-held corporation with a big accumulation of what today are tax-free surplus items you had better get rid of it fast.

Senator Everett: Just coming back to the CMA brief, although you have not given consideration to this fact, do you believe that there is a case to be made for a simplified form of distribution by means of a flat rate of tax payable by the corporation of closely-held corporate surpluses?

Mr. Macintyre: Yes, Senator Everett. A case can be made for that, definitely. I don't know whether we have considered it and are in a position to put forward any specific proposals. Paragraph 105 seems to work, but there are a great many technical anomalies associated with that. There is some pain and nuisance involved in going through this process. I would think the results are there, and if some mechanism could be put in somewhere to achieve the results with a simpler process, that would certainly be worthy of consideration.

Senator Everett: It would be an essential corollary, then, in your mind to the increase of a tax dividend credit from 20 per cent to 25 per cent.

Mr. Macintyre: I should like to think about that before answering, senator.

Senator Everett: I should like to refer you to clause 93 on page 20, in which you recommend that some mechanism be provided to permit a widely-held corporation to revert to a closely-held corporation.

Do I gather from that that the CMA is in favour of the distinction between widely-held and closely-held corporations?

Mr. Macintyre: Section 93 of our brief must be read as prefaced by paragraph 88, in which the last sentence reads as follows:

> While we strongly disagree with the integration/capital gains package in the White Paper, in the ensuing paragraphs we offer comments in the event that some or all of those structural concepts are proceeded with.

All the ensuing comments from paragraph 88 on through paragraph 102 are on the

premise that, if the system is to be adopted, this is what we would recommend. Our general feeling is that the widely-held/closely-held distinction is artificial, unnecessary and would lead to a host of avoidance complications not yet dreamed of. As an association we respect that distinction, except in so far as we do, as referred to earlier, endorse the optional partnership election for small corporations.

Senator Phillips (Rigaud): You are saying that if we are to live in sin in terms of integration there ought to be some rules about it. Is that it?

Mr. Macintyre: Agreed.

The Chairman: That is a fair statement, Senator Phillips.

Senator Phillips (Rigaud): Mr. Chairman, I should like to refer to resource industries, if I may. Paragraph 16 on page 4 is rather interesting and is worthy of quoting. You say:

> The Association considers that the proposal to phase out the three-year exemption for new mines and for depletion allowance to be "earned" would reduce the growth of the extractive industries with a resultant slow down in the growth of secondary industries and in our export income. The Association considers that the existing incentives should be continued.

This committee has listened to a number of very interesting briefs from the natural resource industries and others. We are flooded with a number of suggestions involving the continuation of the tax structure as is as against revolutionary changes, some of which include the distinction between oil companies and mining companies and a further distinction between ferrous and non-ferrous companies, and yet a further distinction involving the so-called bonanza companies who have done so well that they hardly need the three-year holiday for continued depletion. With that background, I should like to ask you whether you have any working papers or material that has led you to arrive at the conclusion in paragraph 16 which I just read, or is this paragraph formulated on the basis of internal discussion among yourselves and a general consensus.

Mr. Laing: The situation that the Canadian Association of Manufacturers is in is that it represents a large spectrum of membership. Some people like myself working for a steel mill have some interests in mining companies as well as manufacturing activities. But the principle concern of manufacturers is that because mining is an important activity in the country, and we sell to mining companies, we are concerned. Now we as manufacturers have not studied too closely, but we think we understand all the ramifications of the income tax situation with respect to resource industries, but some of us from the oil industries and mining industries have some knowledge of it and have some understanding of what the people involved directly in mining are saying and we respect judgment on it. It is for that reason that we do not have working papers because we have tried independently to evaluate it.

Senator Phillips (Rigaud): I just wanted to know if you had something that might be helpful to us.

The Chairman: Mr. Laing, I want to put this question to you on the subject of incentives; we have had statements here from the mining industry and the oil industry that they should not be coupled together. They feel they should be treated separately on this matter of incentives. Now, quite apart from that, if we take the mining industry for a moment and take the tax holiday which is an incentive which has been enjoyed by the mining industry for a long time, we find that the White Paper proposes doing away with it. Now, there are many areas in the mining industry and you will find that mining companies that are successful have followed the practice of writting off no pre-production expenses during the period of the tax holiday, and they commence that write-off after the tax holiday is over. The net result of that is that they enjoy a tax-free ride for six or seven years. Now, I do not know whether this is what the White Paper terms an abuse or not, but do you have any ideas on the question as to whether that situation, if it continued to exist, is a non-justified expansion or application of the tax holiday?

Mr. Laing: There are two aspects to that question. One question is; is it an unjustified tax incentive? That is the three-year exemption plus write-off.

The Chairman: Plus postponing the write-off which they may take at any time.

Mr. Laing: We think the present system has covered a wide variety of circumstances, and in some I think it could be stated that it may be unjustified, but for others who fall into

that same provision, it could be clearly justified on the grounds that there would not have been that economic activity in Canada unless there were that situation.

The Chairman: This is what the White Paper says.

Mr. Lees: Mr. Chairman, with my previous connection with the iron industry in northern Quebec...

The Chairman: Well, I was going to come to that. This question falls into a different category. We have heard from the iron ore industry, and I realize there are different aspects and I was going to touch on them in a moment. Now, I do not want to shut you off, and at a later stage I will put a specific question to you. But at the moment what I am trying to point out is that there is a significance, and maybe you can say there is a value in retaining a format for capital financing and getting risk capital which has come to be known and recognized and acted on by the capital markets. That is the combination of the tax holiday plus depletion allowances. We have been told that if you change the format, the capital market which is the source of supply for risk capital will have to be re-educated, and therefore there may be a period when it will be difficult to do capital financing in respect of many mining properties. Now, if you accept that for the moment, you could retain the tax holiday and put some restriction requiring that some portion of the pre-production expenses either on an amortized basis in respect of their borrowed money or whatever it is to reduce that operation must be written off through the period of the tax holiday. Now that would prevent what the White Paper seems to conceive as being an abuse of the tax holiday system. What would you think of that?

Mr. Laing: I think it might apply in the case of some mines, but it would not deal with the abuse in respect to others. There may be some mines that have a relatively high proportion of their total expenditure in the field of pre-production costs and others with a relatively low proportion in it. So I am not sure that that type of provision would deal with both problems.

The Chairman: The chips would have to fall where they would if you put that restriction in there. If they had a small proportion of pre-production expense—I find that difficult to envision at the present time or to conceive what mining company might be in that category. They either have buildings or equipment which are entitled to depreciation, and the law permits that and they can take a maximum rate or any part of that rate. But I am talking about everything else that is encompassed within the description of pre-production expenses. If it is a little, then they would only be writing off a little in that period.

Mr. Lees: But they might have written it off before the exempt period commences.

The Chairman: Well, the tax holiday is only an entitlement that you get for a new mine, and therefore every time you are going to have a new mine and you want a tax holiday, you need a new company. The same company is not going to get the tax holiday twice.

Mr. Lees: It has been the practice.

The Chairman: Maybe on expansion. However, we can settle this question pretty fast. Mr. Gilmour?

Mr. Gilmour: Under our present Income Tax Act, section 83(5) says that you are entitled to a three-year tax holiday from the income of a mine, but it does not say whether it is a new mine or anything else. At one time we did have court decisions that said that a revival of an old abandoned mine was the equivalent of a new mine. And I suppose, in theory, if you had had a mine obtain a three-year holiday and then abandoned it, and some years later you came back and re-opened it, then you could bet a three-year holiday on the same deposit. But very recently the Supreme Court has spoiled such a happy thought, and today I would imagine it is just about impossible to get a double three-year tax holiday on the same mine. I think, in practice, from the briefs that your committee has heard to date, probably the principle criticism of the three-year holiday would apply to the very rare cases where your mineral deposit is extremely rich. I think most of the witnesses referred to the Pine Point Mine where by some freak of circumstance I do not think the ore even needed refining because it was so rich. Obviously, the lucky owner there did not need a three-year tax holiday or any holiday at all. I also recall from our witnesses that there are not many Pine Points in Canada.

The Chairman: Unfortunately!

Mr. Gilmour: Yes. We also gather that rarely do you find an extremely rich ore body

that is also long-lived. So, so far as I could judge, the valid criticisms of our three-year tax holiday and our percentage depletion would apply if there is a rich find such as Pine Point, because obviously the owners of that mine received an advantage they really did not need.

Similarly, if you happen to have a mine that lasts for eternity or for a very long period, then obviously our present system of giving $33\frac{1}{3}$ per cent does give you an unwarranted allowance into perpetuity.

Of course, applying the acid test of fact to these things, we are told there are not that many very long-lived mines either, so, therefore, it would seem in trying to find a reasonable solution it might be possible to put some kind of a check on the amount of the three-year tax holiday. In other words, if you need it, you get it; if you do not need it because of rich ore, stop it at the month when you cease to need it.

Similarly with depletion. I am told the average life of a mine in Canada is about 21 years. Why not consider the possibility of allowing depletion in our present basis, or any basis you like, for, say, 21 years and then cut it, so that the fellow who has a really long-lived mine has his benefit the same as anyone else? I think that might meet the criticisms that apply to the exception in the Canadian mining industry rather than the rule.

Senator Phillips (Rigaud): We are still on the natural ersources. Formally, your recommendation is that we leave things as they are, and you have given the reasons for it.

This is the first time I think this question has come to my mind. If we follow the simple system of laissez faire and say, "All right, here is your three-year holiday, here is your depletion allowance, and we carry on as is." The question arises: Is there any merit to the point that if companies are availing themselves of the tax holiday and depletion, their rate of taxation in respect of taxable income before the depletion shall not be less than, say, 25 per cent, 20 per cent or 15 per cent?

We are trying to overcome the natural criticism of the public at large that although the natural resource industries are entitled to incentives and all that sort of thing, taxpayers generally are not exactly in easy brackets these days. The feeling is that notwithstanding the incentives it is a little troublesome to see major companies continuing to make substantial profits year in and year out, without contributing to the needs of the country. Would it not be fair to say, on an overall picture, without attempting to draw the differentiations, that somewhere down the line the natural resource industries must not end up indefinitely in a period of tax deficit operations without an inflow of money?

Mr. Laing: That is a broad question. "Is it fair" was the question.

Senator Phillips (Rigaud): We have to consider these problems.

Mr. Laing: Can I try to deal with it to some extent? As the Manufacturers' Association, we have to decline to say, to some extent, because we are not able to understand what the implications would be in every case, or even generally, in the type of proposal you are suggesting. If I understood it, if the tax holiday and depletion together—and, I presume, for a mine, over the life of that mine—would result in the income of that mine being taxed at less than 20 or 25 per cent overall, then maybe some kind of limit might obtain. It sounds like the type of alternative that should be looked at, but I can see a host of problem in trying to deal with it.

The other thing I think should not be lost sight of in talking about resource industries, when you look at corporation income tax only, is the fact that there are other taxes involved as well. That is where it becomes quite difficult to deal with the question: "Is it fair?"

Can I revert briefly to two questions that came up a little earlier, Senator Hayden?

The Chairman: Yes, certainly. You are going away from this subject?

Mr. Laing: No, the same subject. It has to do with your comment: Can one company enjoy more than one three-year tax holiday? Yes, it can, as long as the mine is separate and distinct. I am not talking about a legal technicality of the MacLean mining type case, but if a company opens a mine in Labrador it can have a three-year holiday, and if it opens up another one in British Columbia there will be a second tax holiday on that second mine.

The Chairman: Depletion was mentioned. The depletion is for the purpose of making risk investment attractive not only to the mining company but to the investor. The depletion, as it exists at the present time, is enjoyed, in part, by the company and, in part, by the investor. The White Paper takes away

that special depletion allowance to the investor, where he could deduct from the dividend that he gets a certain percentage, depending on the nature of the mineral. Have you looked at that, or have you any comment you would like to make on that? The White Paper does not really deal with an incentive to the shareholders, because the integration is for every shareholder of every company, so the investor is not getting any incentive consideration under the White Paper proposals.

Mr. Macintyre: I agree with your comment, Senator Hayden, and I think the White Paper has a two-fold effect on the shareholder in the resource industry. The White Paper not only proposes to remove the shareholder depreciation allowance, but in addition those proposals with respect to creditable tax tend to nullify at the shareholder level the depletion and a variety of other incentives that are offered at the corporate level, such as the low rate on the first $35,000—that is to be retained—scientific research incentives, and a variety of others.

The Chairman: Yes, that is quite true. While the White Paper agrees that special incentives are needed in the mining industry, and the Government is going to set about seeing that it gets them, it ends up by giving the shareholder or the investor no incentive.

Mr. Macintyre: That is correct. I think the classical example of that would be found in the case of Trans-Canada Pipe Lines. I do not know whether this has been explained to this committee or not.

The Chairman: No, but they are appearing before us in another week or ten days.

Mr. Macintyre: Perhaps I should not steal their thunder other than to say that clearly relative to the present system the lack of creditable tax in their case would significantly reduce the incentive of Canadians to own shares in such a growth company. At the same time, the attractiveness to the non-resident who is unaffected by the integration proposals is unchanged. You have, as our brief points out, the anomalous effect of the resource companies, the growth companies, becoming more attractive to the non-resident shareholder whereas with integration the Canadian shareholder is more attracted to the mature companies, as a witness referred to them last week.

The Chairman: Are there any other questions on this phase?

Senator Connolly (Ottawa West): The witnesses have heard Mr. Gilmour talk about the average life of a mine in Canada being 21 years. I might take the Pine Point deposit as an example. That is a very rich deposit which requires very little treatment. There is no refining done at all, and they do what they call direct shipping of the ore. Then, as time goes on they get into a lower grade of ore, and immediately fall into the class of manufacturers, because they start installing equipment and facilities to—and they use a word which I guess is not in any dictionary—beneficiate the ore, which means that they concentrate it. The product, which is a manufactured product in a sense, is a higher grade of product. In the White Paper Proposals none of these installations is considered to be appropriate for the depletion allowance. If the formula in the White Paper of three for one were to be continued, would you consider that such expenditure should qualify for depletion?

Mr. Laing: One of the earlier questions was as to whether we had any working papers to support this. We have not made any studies in the Tax Committee of the C.M.A. that would enable us to answer that question.

Senator Connolly (Ottawa West): Do you think the test for the tax level in the resource industries is ultimately the effect that it has on the competitive position of a company in foreign markets?

Mr. Laing: That is one of the tests. One of the tests that we as manufacturers would be concerned about is whether there is a good level of mining activity in Canada. We understand that the present tax situation has been satisfactory for a wide variety of mining activities in Canada. That has a twofold aspect. It has enhanced economic activity in Canada, and it has also made a real difference in whether those companies can compete by selling their product abroad.

Senator Connolly (Ottawa West): Yesterday I listened to the evidence given by the mining companies before the committee of the House of Commons, which is doing a study like this. A question asked there was whether or not the depletion should run for a specified number of years, either at the present rate of $33\frac{1}{3}$ per cent or 25 per cent, and the answer that was given by the witness, who was the president of one of the important mining companies in the country—I think it was Noranda, and he may have given the same answer here—was that if you give it for a

certain number of years then at the conclusion of that period the product is immediately going to be competitive, particularly in world markets. This seemed to be the test. Would you agree?

Mr. Laing: I do not know Noranda well enough, but it is quite possible.

Senator Connolly (Ottawa West): He was talking generally; I do not think he was talking about Noranda.

Mr. Laing: I think that is quite possible.

Senator Connolly (Ottawa West): Do you think it is a criterion for this committee to consider when it looks at this question of unearned depletion?

Mr. Laing: I think so. One of the things mentioned in the White Paper that the Government is concerned about is the effect of the proposals on the balance of payments, and I think that that falls right into that category.

Senator Connolly (Ottawa West): Would you have a view on whether a lower rate of unearned depletion plus the provisions for earned depletion in the White Paper Proposals might ultimately work out? You have to think about the fact that the Government is looking for more revenue from taxes, including taxes on the resource industries. With this kind of combination, do you think it makes sense?

Mr. Laing: We have not done any work that would enable us to give an opinion on that.

The Chairman: Mr. Lees, you have had some experience in this area.

Mr. Lees: The senator's question reminded me of the problems you run into when you set up a large mining venture. Those three iron ore mining ventures in Northern Quebec are good examples. The one I was associated with had to spend $200 million on railroad and railroad equipment and hardware alone. These items, in an economic sense, have a very low return or practically no return at all, and the capital cost allowance on them is very low. It is 4 per cent or 6 per cent per annum. Some of the mines would be exhausted long before the assets were written off.

The company I was involved in had to decide whether they spent their money in Minnesota or whether they spent it in Quebec. The tax exemption plus deferral was the incentive that brought that investment to Quebec, and the reason was very simple. It was cash flow. The company was not about to gamble in an area where there was no established labour force, no established infra-structure, unless it got its money back fairly early, and had a good prospect for a return after that. The existing structure worked beautifully for that. I just cannot believe that what is proposed in this White Paper will ever make a new Iron Ore Company of Canada, or a new Quebec-Cartier or Wabush, because you are talking about big bond issues and debentures. You also need a lot of newly generated capital from the steel companies. The same applies to the aluminum companies in certain parts of the world. You are entering into huge bond issues and the difficulties of servicing debt, and you have to have everything going for you in order to justify that investment.

I do not know much about putting small holes in the ground, but I do know that with the large integrated aluminum and steel industries this type of package works very well in keeping them interested.

Senator Connolly (Ottawa West): It would be a lower rate of depletion and also in line with what Mr. Gilmour said, for a limited period of years.

Mr. Lees: I do not think people would argue with you. They would simply take certain deposits and when they cease to be interesting they are out. They would also ask would you pay half the cost of the railroad?

Senator Connolly (Ottawa West): Would it add to the social fabric in a remote area of the type you have described?

Mr. Lees: It created it; there was no social fabric.

Senator Connolly (Ottawa West): In the event the White Paper proposals are implemented and incentives taken away, what would happen to the social structure there in your view?

Mr. Lees: In my view when those industries close the people will leave. It is an inhospitable climate and the only inducement for them to be there is industry which will pay good wages.

Senator Connolly (Ottawa West): Perhaps this question is theoretical from both points of view. We are told that we have great resources as yet untapped in the north. Do you think that the proposals of the White

Paper are sufficiently attractive to induce, first of all exploration and, secondly, development in remote areas?

Mr. Lees: I know of only two industries with any confidence. Those are steel and aluminum. If you refer to bauxite or iron ore deposits, which have to be very large scale, with heavy use of internally generated capital, the answer would be no.

Senator Phillips (Rigaud): In the final analysis we are facing with respect to the natural resource industries the fact that government usually does not like to admit that special categories of taxpayers receive special treatment. Therefore they are subjected to the normal rate of corporate taxation. Then they go in through the back door with tax holidays, depletions, and that sort of thing to produce results which are sometimes very unsatisfactory.

I am leaving aside the question of preproduction expenses, which are normal expenses, and capital cost allowances. My question deals specifically with tax holidays and depletions.

What would you think of a simple plan, pursuant to which the Government had the courage to say to the natural resource companies, because they are associated with incentive and the necessity of developing the resources of this country: "There will be no tax holiday and no depletion allowance, but a flat rate of 50 per cent, or X percentage of the corporate rate"?

After all, we are dealing with income taxes and profits. We would say to the natural resource companies: "We know that you have a special problem. We want to continue your incentive to go to the north country and we recognize you as being in a special category. When you make profits we will take a portion less than we take from people not involved in risk, maybe 50 per cent of an existing corporate rate."

I am not saying that I have thought this out particularly.

Senator Connolly (Ottawa West): Senator, when you refer to taxes for resource industries, do you include the provincial taxes? They are also considerable.

Senator Phillips (Rigaud): Yes I do.

Mr. Laing: Yes. A broadly applicable arrangement of that nature is probably a better way to proceed than in a selective manner.

The Chairman: The administration would be very simple.

Mr. Laing: Yes.

Senator Phillips (Rigaud): It is also less deceptive and more courageous.

Mr. Laing: I am sure there would be some development that it would not suit.

Senator Phillips (Rigaud): Yes, it would hurt some taxpayers, but at least it would have the advantages of simplicity and saying what it means.

Senator Connolly (Ottawa West): The question of the level is the important aspect in relation to incentive.

Senator Phillips (Rigaud): I am thinking of the simple approach to this whole question of a natural resource industry.

The Chairman: We will move on to the next heading in your list of five special headings. We have not dealt with the third one, your position on the capital gains tax.

Have you anything to add to what you have said in your summary and brief?

Mr. K. O. Fowler (Texaco Canada Limited), Chairman, CMA Subcommittee on Capital Gains: We have nothing in particular to add. One of the senators asked if there was any proposal in our brief that some of the recommendations should be phased in over a period in order to lessen the impact of the package as a whole.

Whereas our recommendation is that there be no capital gains tax at this time, if the economic conditions of the country become such that it is felt that such a tax would not be damaging to the economy, we feel that it should be phased in over a period, with lower rates. In any case, the maximum rate after it is in full effect should be substantially lower than the normal rate proposed by the White Paper.

The Chairman: A very substantial Canadian firm suggested to us a rate of 15 per cent, that it be a separate tax and that losses be written off only against gains, as in the United States.

Senator Connolly (Ottawa West): When realized.

The Chairman: Pretty well. The reason they gave for the lower rate of 15 per cent was that there is a special capital market in Canada attracted to the resource industries.

When the market has run its course and they have had a capital appreciation of what appears to be enough as far as they are concerned and the character of the operation is changing to investment, these people will sell out. Their money again enters this special type of capital market for re-investment. This is a considerable source of re-investment capital for risk enterprises. Therefore they said the rate should not be so high that they would prefer to retain their shares rather than sell.

Does that appeal to you, or seem to make sense?

Mr. Fowler: Yes, we have not suggested a specific maximum rate. We do not consider a capital gains tax to be desirable at this time. However, something in that order would be satisfactory at some future date.

As far as capital gains are concerned, considering the state of the stock market at the present time, we are particularly concerned that valuation day might be declared...

The Chairman: Well, if valuation day occurred at the present time there would be tremendous capital gains taxes later on.

Mr. Fowler: Which in reality recover losses.

Senator Everett: I would like to deal with section 97 of your brief. It appears under Corporations and Their Shareholders, as opposed to Capital Gains. It deals with the problem of starting a system which I think, Mr. Fowler, could have an effect on subsequent capital gains. You make a statement in there as follows:

> Although good will is not explicitly mentioned in these sections, there are indications that good will existing at the time of "starting the system" would also serve to reduce creditable tax after the system comes into effect.

Is it your opinion that this constitutes retroactive taxation?

Mr. Fowler: Yes, it is.

Senator Everett: Would you care to enlarge on that for the committee?

Mr. Fowler: This applies, I think, particularly to closely held corporations. The responsibilities will be placed on the directors of the company to declare a value of the shares at the starting point. Any value in excess of the underlying value of the assets, which presumably will be good will, will give rise to non-creditable tax at a graduated period, I think over five years, or something like that; one-fifth of the taxes paid each year will be deemed to be non-creditable until there is sufficient tax set aside as being non-creditable to cover the tax on the good will. I think this is a form of retroactive taxation. It means that the tax is, in effect, being paid by the shareholder.

Senator Everett: Would you agree with this statement from the White Paper:

> ...it is stated again that the solution for closely held companies appears to be to coerce shareholders into valuing their shares at book value, with the consequent result that good will gains upon disposal of the shares would be subject to tax. Alternatively, shareholders may be allowed to value their shares at market value, but this would have the effect of creating goodwill in the company which would result in a certain amount of creditable tax being lost, with the result that some portion of the earnings of the company would be fully taxable again upon distribution.

Mr. Fowler: I think that is true. Yes, I think I would agree with that statement.

Senator Everett: Generally, that statement is true?

Mr. Fowler: Yes.

Senator Everett: Generally in the mind of the C.M.A. this constitutes retroactive taxation?

Mr. Fowler: Yes.

Senator Everett: Prior to valuation date?

Mr. Fowler: Yes.

Senator Everett: Is it the view of the C.M.A. that this is unfair?

Mr. Fowler: Certainly.

Senator Everett: Does the C.M.A. have any solution to the problem?

Mr. Fowler: Well, we are opposed to the integration proposal, and this is one of the reasons why we are opposed.

Senator Everett: Beyond the generality of getting rid of the White Paper, do you have any solution?

Mr. Macintyre: If I may speak to that. Paragraph 98 of our brief explicitly com-

ments on it. While we do not endorse the system, if the whole system comes into effect we suggest it would perhaps be less inequitable if the cost basis of the shares for capital gains tax purposes were adjusted so that there would at least not be an immediate impact on the shareholder. If the problem is considered to exist, at least it would be deferred until realization, but in any event it would represent a form of retroactive capital gains taxation.

Senator Everett: Even under your solution?

Mr. Macintyre: Yes.

Senator Everett: But it would not mean that that portion of the increase in value would not create creditable tax?

Mr. Macintyre: That is correct. The solution in paragraph 98 is an alternative that ameliorates but does not eliminate the inequity.

Senator Everett: So there would be creditable tax for the difference between both what you call the unrealized depreciation and the good will fact?

Mr. Macintyre: Yes.

Senator Everett: But on sale of the shares, what would your base value be of those shares?

Mr. Macintyre: I would assume that there would be an adjustment of the cost basis of the shares to the extent that the original valuation contained intangible asset values; that is, over and above the real value of the underlying assets, of the tangible assets.

Senator Everett: Why would you not accept the idea that the shares are valued to include good will?

Mr. Macintyre: That would be a more equitable solution certainly.

The Chairman: And it would be more realistic.

Senator Everett: And the base for creditable tax would be the difference between the value of the underlying assets and the good will assets of the shares.

Mr. Macintyre: Yes.

Senator Everett: And on sale of the shares the base is the initial value that you put on?

Mr. Macintyre: Yes.

Senator Everett: Including good will?

Mr. Macintyre: Yes.

Senator Everett: Because, indeed, is it not true that the purchaser of shares cannot write off the good will?

Mr. Macintyre: Correct.

Senator Everett: The purchaser of assets can write off good will, but the purchaser of shares has nothing to write off.

Mr. Macintyre: That is correct.

Mr. Lees: The difficulty the White Paper foresaw is that the owner of a closely held company with good will in it, if they did not do something, would sell the good will, pay the tax on it, because he had an appraised market value for it, or would get the preferential rate of tax set up in good will in the White Paper itself; he would then declare a dividend which would come through to him as creditable tax enough to cover almost all of it; then he would sell his shares for a nominal sum of $1 and claim a second deduction, and obtain a windfall tax benefit.

Some of us have thought that one of the cures of this is to borrow a lesson from paragraph 6.19 in the international section, where they prevent you doing this in the case of a foreign subsidiary by making you reduce your carrying value of the shares by the amount of the dividend of existing surplus at the date the law comes into effect. It is a very tricky subject, and you have to be very cautious about suggesting answers. Surely the White Paper has a problem, in that you have double benefit if something is not done. This is what we do not like, that the Government takes its pound of flesh immediately by reducing creditable tax at the outset, when probably part of the just answer is for them to work out a scheme to reduce the valuation of the shares in the event the shareholder does the forbidden thing, which is to sell the good will separately.

Senator Everett: In other words, to attack the problem instead of the whole area?

Mr. Lees: Correct.

Senator Beaubien: I would like to ask Mr. Bruck how many people, roughly, the members of the C.M.A. employ.

Mr. Bruck: I do not have that statistic here.

Senator Beaubien: Could you give us an idea?

Mr. Bruck: I would remind you that we have over 5,000 manufacturing companies in the country, and all the largest ones are members of the association. We do not have the statistic you ask for.

The Chairman: Was your question not how many employees the Canadian Manufacturers' Association has?

Senator Beaubien: Yes.

The Chairman: Or was it the membership number?

Senator Beaubien: The member companies.

The Chairman: It is a large number.

Senator Beaubien: Perhaps we could get that information.

Mr. Bruck: We can get that for you.

The Chairman: Are there any other questions on this particular phase? There is one item which appears to be left in this list of special headings, and that is the economic impact. The comment in the summary which Mr. Bruck read was that the White Paper does not deal adequately with the economic impact. We say that the White Paper proposals would depress the potential rate of growth of production and employment. Have you made any study on that?

Mr. G. C. Gibb (Canadian International Paper Co.) Economist, Canadian Manufacturers' Association: Our reaction to the White Paper is that there seems to be a concept that the level of gross national product and the level of revenues are fixed quantities. In our view there are possibly different rates of gross national product which will, with a given tax rate structure, yield different amounts of government revenue. Also the needs for government expenditures may vary depending upon the level of the gross national product.

The Chairman: It may vary inversely?

Mr. Gibb: Possibly. The White Paper seems to give no concept as to an objective of altering our rate of growth so as to generate additional funds out of a larger taxing base from a given rate structure, or perhaps a lower rate structure and, conversely, by generating a larger gross national product and, therefore, for a larger level per capita income, reducing the needs in some sectors of the economy for welfare services or for regional disadvantages. This is the gist of this proposal.

In our view the thrust of the White Paper proposals is to depress the rate of growth, which in this country has been fairly satisfactory in the past. We have kept pace more or less with that achieved in the United States in terms of gross national product per capita, which is a rough measure of our standard of living. I regret to say that we do not seem to be making any progress toward closing that gap, although I think intuitively this is an aspiration of every Canadian. I feel that the White Paper should have given greater thought to the possibility of accelerating our rate of growth.

We have evidence in the United States in recent years where tax reductions have been applied to generate faster economic growth. I grant you that this was done several years ago when the business cycle was at a different stage than it is today.

We have proposals which will tend to make it more difficult to attract and retain the key people in dynamic business organizations. It has been suggested that this can be done by paying them higher salaries. To some extent this may be possible, but it will reduce our competitive position and make us more vulnerable from competition in other countries which do not face the same penalty.

The proposals to tax capital gains, whatever some may feel about the equity of this proposal, is that it represents an additional tax increase over what we have had. It will work in the direction of slowing our rate of economic growth. The White Paper itself admits a reduction in the amount of private savings which will be possible in the country. In my opinion and also in the opinion of the CMA, this will be a dangerous step to take at this time, especially if one has the concept that we want to accelerate our rate of growth over what we are likely to achieve even under the present tax system.

I submit that the proposals, as fully implemented, would reduce our potential rate of growth—it is very difficult to put a figure on it—by perhaps a half or a full percentage point a year. I feel this is the thrust of this statement.

The Chairman: You mean by taking out of the availability for the capital market more of the savings of people who are the contributors to the capital markets.

Mr. Gibb: That is right. There will be a reduction of savings in this space age, this highly technological age today. We must take advantage of new technologies. New invest-

ment is required and we should be emphasizing the build-up of capital investments and in productivity-related activities and not in the reverse, as the White Paper seems to do. We should concentrate on employing and attracting the best brains, and not—as the White Paper proposals would do—make it more difficult for them to continue employment in Canada. I am sure this is going to take some time to develop because we do build in a rigidity test.

Young people coming along are the ones who are going to be affected. They are looking at these unfavourable rates of taxation. They are going to be less attracted, and there will be more who will leave the country to seek opportunities elsewhere. But this will not apply to everyone, so let us not be extreme about it.

The Chairman: It is the trend?

Mr. Gibb: That is right.

Senator Molson: In the view of the C.M.A. implementation of the White Paper proposals, would it create a really significant increase in the difficulty of the taxpayer, both corporate and individually, in reporting and in dealing with the Government.

Mr. Laing: There are two aspects. One is that the group of taxpayers and corporations are a part of them. I presume you have seen the Department of Finance, the explanatory circular suggesting how corporations could keep their shareholders informed. It took them 19 pages to explain how it might be done. We have a suggested form of the T5 slip as I understand it. This gets back to our point about change and how to do it. People are used to getting T5 slips and they know what to do with them.

The Chairman: This may be a modern concept of simplicity. Simplicity may be a relative term.

Mr. Gibb: This is like standing it on its head. We think T5 slips could become quite complicated. Some of the directors of our company said they would find it quite difficult to understand what was being reported to them. They have received a $100 dividend but apparently should put some other figure on their tax return—whether it be $119 or $200. From that point of view it would be quite difficult to understand.

There are others here who could also explain from a personal point of view the type of problems that arise with respect to capital gains and reporting, while keeping track of the cost of the assets you have which might give rise to capital gains in the future, and then trying to satisfy the tax department, when you do have a gain, of the amount of the gain. Generally, on those aspects we think there are considerable complications for the taxpayer.

Senator Molson: Does that mean that there is any feeling on the part of CMA that the White Paper proposals present sufficient difficulties to make its implementation quite a serious matter, perhaps even making it not impossible but difficult to implement?

Mr. Laing: It certainly does. That is one of the reasons we have looked at the integration proposals. The objective is first-class. It is good if there is some way that investment in Canadian shares by Canadians can be encouraged, but then when you break it down and see how it might work, you find that there are so many complications that it would be terribly cumbersome to put into effect. It is just not a workable way of doing it. That is why we give our proposal as a simpler way of doing it, namely, increasing the dividend tax credit.

Senator Carter: Because of the nature of the manufacturing business, is the effect of the tax proposal on the manufacturing enterprise different from the effect on other types of enterprise?

Mr. Laing: The distinction we should be looking at is the commercial activity other than manufacturing; that is, service businesses, insurance and financial businesses. With respect to the service group I don't think there are real differences in the possible impact. I don't know about the financial businesses, although with respect to insurance companies and banks the situation has already been changed quite a bit.

I don't know that the impact on those businesses would be significantly different from the impact on the manufacturing businesses.

Mr. Lees: Mr. Chairman, where you have large enterprises that are integrated and have several subsidiary corporations, the proposal to permit them to pool their income by virtue of the partnership option has to be considered a plus. We have always had problems in Canada with the subsidiary which has a bad time for a few years and loses money. Most countries—Britain, Finance, Germany, the United States—have ways in which you can pool the taxable income where you have

substantial control—75 per cent or more of the shares. The White Paper has gone a long way to meet this objective. This has to be regarded as good. For years the CMA has been trying to find some way of doing that. The manufacturing enterprises that are expanding by acquisition also say that it is a good thing. The possibility that you can do away with the problem of non-deductibility of interest, because you have the partnership option when you acquire a new company, has to be regarded as good, and it will help rationalize Canadian industry into larger, more viable financible units.

Our hang-up is when we get down to the shareholders and the pay-out to the private owners of the business. That is where the cracks begin to appear. Leaving aside for the moment the mining and oil industries and their problems, and just looking at the manufacturing businesses, the cracks appear when you come down to the shareholders level. You also have some cracks when you go far enough and look at the situation with foreign subsidiaries for raw materials.

But as I tried to stress earlier, the picture is not all black. There are some benefits in this system. There are problems, however, and accounting, for one thing, will be immense. When the directors declare a dividend they will have to know how much tax there is so that we can declare a creditable dividend. The problems the accounting system will have in putting up proper numbers for the directors will also be immense.

All of us have worried about that and we have done our homework in another organization called the Tax Executives to submit to the Government a detailed list of the purely administrative problems—and they are quite large. We will all add a minimum of one person to the payroll just to keep track of this stuff.

Senator Carter: You say in your brief that the White Paper proposals do not take into account the commodity taxes. Does that have much impact?

Mr. Laing: We think they should be looked at now. That is our concern. There are alternative changes that could be made in the sales taxes as they presently apply. There are sales taxes at different levels, both federal and provincial, and that is one aspect that could be looked at by the Government when it deals with the provinces. Possibly a simplified sales tax structure could be established. They could then look at what the revenue from that might be and how it would fit into the revenue requirements of today.

Senator Everett: On page 15, your item 68 states that:

> The Association believes that it is relevant at this point to emphasize the need for an early reform of our tax system which would place greater reliance on indirect sales taxes, with a complementary reduction of corporate profit taxes.

There are those who believe that the impact of our direct taxation should not greatly exceed that of the United States and that, if there is a greater requirement for revenues due to the lack of productivity in Canada as compared to the United States, that difference in revenue should be made up by indirect taxes rather than by direct taxes. Would you care to comment on that statement I have just made in reference to the statement you made in item 68?

Mr. Laing: The way the comment was put was that, if there were less reliance on income taxes both personal and corporate, any deficiency that would result from changing them downwards should be made up through sales taxes. We have not done an assessment, or even made an estimate of what would happen if the income tax rates were reduced by, say, 5 percentage points or how much revenue that would involve or how it would affect sales taxes. We have just not done an analysis to the extent necessary to be able to respond precisely to your question. Our main concern is that in general terms, if there is a revenue problem, the sales tax area should not be ignored when the Department of Finance is trying to deal with the revenue problem.

Senator Everett: But I have taken you one step further to the concept that, as I will reiterate, the impact of direct taxes should not be substantially different from that imposed by the United States on its taxpayers, and the difference required by Canada should be made up by indirect taxes. I am not asking you for specific figures. I am asking you for your reaction to that principle.

Mr. Macintyre: Senator, I think our brief makes the point that in order to improve our competitive position internationally, it is perhaps not good enough to say a rate comparable to the United States, but perhaps even lower than in the United States. Paragraph 67 indicates the disparity, and I think a general lowering of corporate taxes here, slightly

below the level in the United States and increased reliance on other indirect or sales taxes without going into the details of what they might be would improve our international competitive position in two ways; it would tend to make Canadian manufacturers more competitive in penetrating still further into international markets and achieving larger sales in Canada. It would also impose a little higher tax on imports, a sort of indirect tariff on imports thereby also giving Canadian industries a slightly increased measure of protection.

Senator Everett: So you generally endorse that statement?

Mr. Macintyre: Yes.

Senator Beaubien: I just want to ask a supplementary question, Mr. Chairman. At the present time we have a 12 1/2 per cent federal sales tax and the Americans do not have any. So how could we possibly increase that now in favour of reduced corporation tax? As I say there is no sales tax at the federal level in the United States at all while we have one at 12½ per cent, so how can you possibly increase that and remain competitive?

Mr. Macintyre: I think, senator, to the extent that the corporate rate were lowered, this, in the first instance, would directionally tend to lower the prices that Canadian corporations charge in the home market. Now if that gap is covered by some sort of a value-added tax, or whatever it may be, there would in the long run tend to be some sort of equilibrium.

The Chairman: But to ensure that, Mr. Macintyre, you would need a more complex system than the White Paper envisages—to ensure that the corrections are made when the corporate tax is reduced and the commodity taxes increased and to ensure that the benefit does flow. Who gives the guarantee that that will happen?

Mr. Macintyre: Well, I do not think anyone can make a written guarantee, but I think this would be the result of the marketplace mechanism. I think it is certainly the experience in European countries that have tended to significantly lower their internal corporate taxes and have moved to fill that revenue void by value-added taxes or internal taxes which are remissable on exports and thereby attracting more international capital and achieving further penetration into international markets. I think there will be a new equilibrium struck, but in the meantime it does give a much larger incentive for the expansion of the industrial base here.

Senator Everett: But, Mr. Macintyre, dealing with the social effect of the concept, would you agree that the higher corporation tax is non-selective in its incidence on the consumer, whereas an indirect tax can be selective so that certain items that are purchased by the consumer could indeed have little or no tax at all.

Mr. Macintyre: Indeed, senator, we have this now with the exemptions from both federal and provincial retail sales taxes for certain essential commodities.

Senator Everett: So that it could be a fairer tax than the increased corporation tax so far as the consumer is concerned?

Mr. Macintyre: I think it could be.

The Chairman: Except, Senator Everett, if you do that, you reduce the revenues. The more things you make free of tax, the less revenue you will get.

Senator Everett: That is the problem with all tax laws except that as you reduce one, you raise the other.

Senator Carter: Just a supplementary question on that point, Mr. Chairman. Are there any instances where the manufacturing tax is applied more than once in the same process?

Mr. Laing: Yes, there is. There are certain items which we as manufacturers buy and on which we pay federal sales tax because they are not used directly in the production of goods. Now, when we turn around and manufacture our product and sell it to those customers who have to pay sales tax, of course we try to the extent that the costs influence our selling prices—one of the costs is the federal sales tax we pay, and so when we charge our customers for a product and then have to add 12½ per cent onto that, it is doubled up.

The Chairman: It is tax on tax, and it is multiplied in the process.

Mr. Laing: Yes. Mr. Chairman, could I ask for one little thing. Earlier there was some comment about small businesses and concern with them and some general questions. Now, Mr. Reed is with us. He is President of Quindar Products Limited which you could call a small or medium-sized manufacturing busi-

ness. I thought, if you had a couple of seconds, Mr. Reed could give a couple of comments about what one small business at least thinks of some of the proposals.

Mr. N. Reed, Chairman, Toronto and District Branch, Canadian Manufacturers' Association: Mr. Chairman, I think generally speaking that small business views the White Paper and its implications with a great deal of alarm. One of the reasons is because they do not understand it. I think this is typical of the small businessman who is not an expert on tax matters. As a matter of fact, he probably has to be an expert at his own business and if he is an expert there, he is doing well. He cannot avail himself of expert assistance unless he comes to an association like the Canadian Manufacturers' Association. But still this is a problem. He has to deal with many government forms and many government departments in the normal course of business, and anything that can be done to simplify a tax change and to simplify incentives that he might be granted would be very useful; and any incentives that are granted to small business should be very evident and not complicated. I think the small businessman is concerned that he should retain his benefit of a low tax rate on the first $35,000. In many cases, indeed in most cases, he relies on his own business to provide the additional investment to plow back to buy more machinery and equipment. He feels he is being crunched a little bit because he feels he is not only going to lose that advantage, but he will be squeezed on his personal income tax because he probably is paying himself and is earning in the area that will be treated by an increased tax rate.

The Chairman: I think, Mr. Reed, it is a fair statement to say that the capital market for the small businessman is retained earnings. Is that correct?

Mr. Reed: Yes.

The Chairman: And a small business generally is not attractive to the investment market, and therefore this is the only place he can look. We have been told this by a large and differing, in many respects, group representing small business. Therefore you have to find some simple and direct way, you suggest, to give him a chance to get his capital and that means putting him in a position where he can retain and apply a larger amount of his earnings to the business.

Mr. Reed: That is exactly the point, yes.

The Chairman: That is what we took as being the principle involved in their way of looking at it.

Is there anything else you want to add?

Mr. Reed: I think that pretty well concludes what I wanted to say.

The Chairman: Well, Mr. Bruck and Mr. Laing, we have run through the points that you stress and we have had a general discussion. Is there any point that we have missed or is there anything further that you would like to say?

Mr. Laing: Well, Mr. Chairman, there is one minor point, if you would not mind. In one part of our brief there is a little summary and if you like, I could read it into the record. It is on page 9, paragraph 46:

> The Association is of the view that the White Paper is open to criticism on four fundamental grounds:
>
> (a) It proposes an overall level of taxation and government expenditure which are incompatible with our present stage of development and our need to remain internationally competitive;
>
> (b) It proposes shifts in the incidence of taxation—individual and corporate—that will penalize initiative and repress capital investment;
>
> (c) It is incomplete in that it proposes nothing about other forms of taxes, such as commodity taxes and estate duties;
>
> (d) It is inconsiderate of the needs of junior governments for tax revenues and could lead to a tax jungle in which any move toward the federal objectives of equity and neutrality is completely thwarted.

The Chairman: Thank you. I do not want you to leave this table until you feel you have put your viewpoint across.

Mr. Bruck: Mr. Chairman, I should like to take this opportunity to thank you and your committee for having received us, and for having submitted us to a rather stimulating examination. We trust that our responses have been satisfactory and again, sir, we thank you very much.

The Chairman: Thank you.

The Chairman: Honourable senators, the next brief we have before us is that of Bell Canada. Mr. G. C. Wallace, the Vice-President

(Finance) is here, and with him are Mr. G. L. Henthorn, the Comptroller, and Mr. D. L. Robertson, Tax Accountant.

Mr. Wallace has a statement to make, and then you will be open to questioning, gentlemen.

Mr. G. C. Wallace, Vice-President (Finance), Bell Canada: Mr. Chairman and honourable senators, as Vice-President (Finance) I am appearing on behalf of Bell Telephone Company of Canada to present our views on aspects of the Finance Minister's Proposals for Tax Reform in which we have a vital interest.

As the Chairman has said, I have with me Mr. George L. Henthorn, the company's Comptroller, and Mr. Donald L. Robertson, the tax accountant.

In opening may I say how much we appreciate the opportunity of appearing before this distinguished committee to discuss our views. Our brief was submitted in pamphlet form some time ago, to give you the opportunity for study, but I would like now to give a brief summary of the major points contained in that written submission. I think there are copies of the summary as well.

The Chairman: Yes, they have been distributed.

Mr. Wallace: As one of the largest taxpayers in Canada—in 1969 our tax bill totalled $184 million—and playing a major role in the country's economy, Bell Canada is deeply concerned with both the basis and extent of taxation and has a vital interest in proposals for tax reform.

General comments:

There are certain of the goals stated in paragraph 1.6 of the White Paper which we think are conflicting. The proposals designed to accomplish the "equity" objectives have been made, in our opinion, at the expense of those concerned with economic growth and the motivation of improved performance.

Of greatest concern to us are:

1. The inhibiting effect of the proposals on both personal and corporate saving.
2. The probable impact on the capital markets for equity and debt securities, both domestic and foreign.
3. The inflationary implications of the proposals.
4. The resulting impact on the general economic growth in the country.

The White Paper forecasts a significant increase in total tax revenues after five years. This represents government appropriation of a larger share of the national product at the expense of corporate and personal savings. The inflationary effect of the proposals will be accentuated if the government uses the additional revenues to embark on new expenditure programs.

The Minister of Finance has stated in the House of Commons that criticism of the White Paper on the grounds that it is inappropriate during a period of severe inflation is unwarranted, as the government expects that inflation will be contained by the earliest date of implementation. Bell Canada feels that, regardless of the state of the economy when these proposals are implemented, it is unwise for the nation to commit itself in advance to a taxation system which is recognized as inflationary and could well inhibit economic growth.

The integration of personal and corporate income taxes to the benefit of residents of Canada is expected to encourage Canadian ownership of Canadian business. As a result, it is likely that a shift from bonds to equities by Canadian investors can be expected, which will lower bond prices and increase the cost of borrowing in Canada. Whether non-resident investors will provide enough additional investment in debt securities to offset such an increase in interest rates is open to question.

In summary, Bell Canada's attitude to the White Paper proposals, from an economic viewpoint, can be stated simply: all taxes are ultimately paid by individuals, and significantly, the largest revenue shifts estimated by the Department of Finance, without any provision for growth, are the gain of $1,255 millions resulting from the proposed rate schedules, offsetting the loss of $1,000 millions due to increasing personal exemptions, a measure designed to help low-income taxpayers. Insofar as these changes, coupled with the proposed capital gains tax and other measures, act against savings and investment and contribute to inflation, this goal will not be reached. The underprivileged in Canada require the job opportunities which can best be provided by private investment, and maintenance of the purchasing power of their earnings. Only if these objectives are attained can other governmental policies add to the well-being of these Canadians.

How the impact on the economy affects Bell Canada:

Bell Canada, as a regulated public utility, is particularly sensitive to the effects of inflation. Inflation will cause companies which supply materials and services to us to raise their prices, thus increasing the operating costs of the utility. Bell Canada, of course, can only adjust prices by applying to the authorities for rate relief. A substantial time period normally elapses before increased rates are approved. During this period of lag, with inadequate earnings, the company is disadvantaged in the capital market. The tax proposals favour equity investments but funds will not be attracted to stocks with poor earnings prospects, i.e., the stocks of regulated enterprises in an inflationary period. We have been made well aware of this over the past few years.

Bell Canada does not have the freedom enjoyed by most enterprises to limit its activities to those which are, or are expected to be, most profitable. The obligation to provide basic telephone services on demand commits the company to a program of expansion and modernization, despite the difficulties which may be faced in financing such expansion. It is therefore essential to the maintenance of an efficient Canadian telecommuications network that Bell Canada be able to raise capital at all times on reasonable terms.

The effects of taxation on the capital markets are therefore of vital importance to Bell Canada and to its associated companies. The significantly increased tax advantage attaching to equity investments will undoubtedly diminish the supply of money available in the domestic bond market. This effect on the capital markets could have serious consequences for corporate as well as governmental borrowers. At the very least it will mean debt costs higher than would otherwise apply.

To alleviate the scarcity of Canadian debt money, and the consequently higher interest rates, Bell Canada recommends that the government reconsider its policy on the non-resident withholding tax as it applies to interest payments. The White Paper proposal is to increase the statutory withholding rate to 25 per cent, while retaining a 15 per cent rate limitation where a reciprocal tax treaty is in effect or can be negotiated. For interest payments to foreign lenders we recommend the elimination of withholding tax completely.

With the anticipated reduction in the availability of debt money in the domestic market, should the integration proposals be adopted, it is important that the capital intensive utilities, as well as other corporate borrowers, have ready access to both United States and overseas sources on the most reasonable terms possible. This can be an important contribution towards lessening the need for increased rates for Canadian consumers.

Some suggested modifications to the proposals re integration:

Bell Canada favours in principle full integration of corporate and personal income taxes with no distinction as between closely-held and widely-held companies. If the government is not able immediately to absorb the loss in tax revenues implicit in such a system, partial integration for widely-held corporations should be regarded merely as a first step, with a plan for full integration clearly established according to a schedule.

A significant problem area is that the benefits accruing to shareholders from the gross-up and credit procedure may be reduced because of tax incentives granted to corporations by the government. This is because the Income Tax Act permits deductions in computing taxable income of capital cost allowances, depletion allowances and mineral exploration and scientific research expenditures which reduce the amount of tax currently paid by many corporations.

As the government proposes that tax credits will flow to shareholders only for corporation taxes currently paid, the situation will exist in many cases where the reported net incomes are not fully tax-paid. If these corporations pay out most of their income as dividends, their shareholders will pay tax at their individual marginal rates, with no corporate tax credit for a portion of their dividend income.

Bell Canada suggests that, when a corporation distributes to its shareholders earnings on which tax has not been paid because of specified business incentive deductions, for the purpose of shareholders' tax credits tax will be deemed to have been paid on this distribution. To prevent the same amounts being credited to shareholders at a future date when the corporation actually pays the taxes previously deferred, shareholders will be required to reduce the cost or valuation basis of their shares by the amount of dividends on which tax was deemed to have been paid. These shareholders will thus be required at some future date, when disposing of the shares or when revaluing them for tax purposes, to pay capital gains tax on these amounts. This suggestion would also avoid

the taxation of intercompany dividends which are not fully tax covered because of incentive provisions.

Capital gains:

Bell Canada believes that it would be appropriate to treat short-term speculative gains as income and tax them at the full rate. However, it must be realized that similar treatment of long-term gains will lessen the attraction of equity investment, counteracting to some extent the positive gains expected from integration. If Canada is to attract the large amounts of capital needed to sustain growth of the economy, long-term capital gains should be taxed at a rate substantially lower than that for ordinary income.

The proposal that shareholders of widely-held corporations be required to pay tax on accrued capital gains every five years discriminates against holders of these assets in relation to holders of all other forms of property. It will cause hardship where a shareholder would have to liquidate part of his investment in order to pay the tax. It will also remove funds from the market and reduce the amount of capital available for private investment.

The estimated revenue from this proposal is $100 million in the fifth year after implementation. This is a substantial sum, but less than 1 per cent of the total federal and provincial income tax yield. Bell Canada therefore suggests that consideration be given to withdrawing this proposal.

The government proposes that a taxpayer giving up residence in Canada be treated as though he had sold all his assets at fair market value and pay tax on any resulting capital gains. This will inflict a hardship on individuals who give up Canadian residence temporarily to further their education abroad, and on employees who are assigned to overseas projects or training courses by their employer.

Other proposals of concern to Bell Canada:

a) Unanswered Tax Questions

The White Paper does not cover capital cost allowances but states that a review of the present system and rates will be made later. There is an indication that the government considers the present rates too high. It is our experience that, as regards telephone plant, the present rate is inadequate in that it does not permit write-off over the service life. It is urged that the government's proposals in this field be issued for discussion as soon as possible, before the White Paper reforms are proceeded with.

b) Low Rate of Tax for Small Corporations

The proposed discontinuance of the low initial tax rate would deprive small corporations of an important internal source of funds. It is suggested that it be retained, but with a limitation on the total benefit to prevent abuse.

c) Electric, Gas and Steam Utilities

The proposal that the federal government will not extend credits for corporation tax in the case of these companies discriminates against their shareholders.

d) Business Expenses

Expenditures on conventions, entertainment and club membership are in many cases legitimate business expenses incurred for the purpose of earning income. The proposal that deduction no longer be allowed would penalize many businesses. The provisions of the present law are adequate to control abuses.

e) Limitation of Foreign Investments of Pension Plans

The White Paper proposes to limit investments of a registered pension plan in foreign securities to 10 per cent of the total assets. This would limit the scope for diversification and for maximization of earnings in accordance with sound investment principles.

Conclusion:

This submission represents an attempt by a large taxpayer which is also a regulated public utility to put forward its comments on the government's proposals in a constructive framework. Many of the criticisms advanced and the technical problems outlined will already have been brought to the attention of the responsible officials, and some of the proposals are already being re-examined by the Minister of Finance. It is hoped that participation in the debate by Bell Canada and its associated companies will play a part in improving Canada's tax system.

That concludes these remarks, Mr. Chairman.

The Chairman: The meeting is open for questions.

Senator Burchill: Mr. Wallace, what is your proportion of debt to equity now?

Mr. Wallace: It is very close to the fifty-fifty mark at the present time.

Senator Burchill: What effect will the proposals in the White Paper have on that?

Mr. Wallace: We would hope that if our forecasts of the impact of integratio on making equity investment more attractive are correct, it will permit us to reduce the proportion of debt in our capital structure and increase the proportion of equity, which we think is not only desirable but necessary.

Senator Burchill: Do you think that the White Paper Proposals will have that effect?

Mr. Wallace: We would hope that they, in part, will have that effect.

Senator Burchill: Then that is a good point for the White Paper?

Mr. Wallace: Yes, in our opinion, as a regulated utility.

The Chairman: What do you mean, Mr. Wallace, when you say you favour in principle full integration of corporate and personal income tax? Do you mean full integration in the sense that the White Paper proposes it?

Mr. Wallace: Yes, I would say so, but that is subject to one qualification, Mr. Chairman, and that is that we recognize with respect to the proposals for integration that there are many problems that remain unresolved from both a philosophical and an administrative point of view. Our qualification would be that all of these should certainly be resolved before the proposals are implemented. We are in agreement with them, subject to the problems not yet resolved being fully dealt with.

The Chairman: You have not exactly said that. You have said that you favour in principle full integration with no distinction between closely-held and widely-held companies. The White Paper's proposal as to integration includes the distinction between closely-held and widely-held companies.

Mr. Wallace: That is one qualification which we have made. We agree with integration from our point of view, but with that qualification.

Senator Everett: Is it not a fact that you make that distinction purely as a temporary measure until there is total integration for all companies?

Mr. Wallace: Yes, we suggest that, if it is too costly for the Government to apply full integration at the present time. It should be considered as a partial measure.

The Chairman: Have you studied that situation to see whether partial integration, including only the widely-held companies as defined in the White Paper, would be financially a situation that the Government could cope with?

In other words, would the loss involved be too substantial?

Mr. Wallace: The loss involved in applying full integration to the widely-held companies would be substantial to begin with. It is in the neighbourhood of $300 million. For that reason we feel that it should be applied over a period of time, with some compensating factors through other means of taxation.

The Chairman: You are really editing the integration proposed by the White Paper by saying that as between different types of corporations it most likely should proceed gradually on a partial basis, being applied first for the widely-held companies.

You also suggest that the inequities in integration should be corrected and you recognize those inequities which are, for instance, that the creditable tax available to shareholders is reduced by the incentives and write-offs which are given to corporations, having the effect of reducing their taxable income and therefore their taxes.

Mr. Wallace: That is correct.

The Chairman: How far is that necessary to the plan of integration as proposed in the White Paper?

Mr. Wallace: We feel that it is desirable. It seems inconsistent to us that the Government should offer incentives, through such means as capital cost allowances, which will benefit the companies with respect to tax then immediately remove those benefits in so far as its grossing up of dividends to the shareholders is concerned.

The Chairman: That was not my question. If this limitation, which for purposes of integration is a creditable tax, is applied calculated at an amount which exludes such deductions, how far would the Government proposal be adversely affected?

How much would the cost or the loss of tax revenue be increased if we add these suggestions to the integration proposals in the White Paper?

It would make it impracticable.

Mr. Wallace: No, I do not think we have made an overall calculation of that. The fig-

ures are not available to us. However, it is something that should be closely examined before the integration proposls are proceeded with.

The Chairman: I am concerned that approval of full integration with a number of ifs and buts and with certain amendments...

Senator Everett: Mr. Chairman, last week when we were discussing this matter with International Sea Products I stated that one large company had made the suggestion that tax incentives be treated as though the tax were paid.

Senator Phillips asked me for the reference. It may have been, Senator Phillips, that I was omniscient, but that is the suggestion contained here, that the defect of integration in that respect could be corrected by this sort of treatment.

The Chairman: But how can you give an appraisal of the integration proposals in the White Paper if you proceed to whittle them away and undoubtedly increase the cost of implementing the proposals.

Senator Everett: By the same method that you whittle away at the White Paper suggestion respecting mining incentives.

Mr. Wallace: If you will refer to the full text of our brief, it is indicated that to the extent that that is done the shareholders should reduce the cost of their acquired shares and at the time they dispose of them the additional tax would be recovered, at least in part, through the capital gains tax.

It would be a question of timing rather than of total dollar values.

Senator Beaubien: Mr. Wallance, when you were discussing full integration, did you mean that you consider it would be right for a shareholder of a Canadian company who receives $12,000 a year as his only income to pay no tax at all, but to receive a cheque from the Government?

I think Mr. Gilmour will agree that that is the White Paper proposal. A person earning $12,000 pays approximately $200 a month tax. However, if his only income according to the White Paper after the five years was $12,000 from Canadian dividends, he would receive a cheque from the Government and pay no tax.

Mr. Gilmour: In effect he would pay no tax.

Senator Beaubien: And receive a cheque from the Government.

The Chairman: He may have a refund.

Mr. Gilmour: Yes.

Mr. Wallace: That would be one of the effects of integration.

Senator Beaubien: Do you think that is reasonable?

Mr. Wallace: It is not totally equitable.

Senator Beaubien: That is an understatement.

Mr. Wallace: To the extent that the $12,000 would be in addition to his earned income, the effect would be the same.

You are referring to a case where this is a person's only form of income.

Senator Beaubien: It would not matter if it were; he would receive a cheque from the Government.

Senator Macnaughton: I notice in the introduction to your proposals that you mention, of course, that you have 250,000 shareholders, 98 per cent resident in Canada. You are paying a tax bill of $183,500,000.

Referring to the last paragraph on page 6 under the heading "How the Impact on the Economy Affects Bell Canada," it is quite obvious that you are a very important company, affecting many, many Canadian citizens. However, you do not pull your punches in that paragraph. You say:

> To alleviate the scarcity of Canadian debt money, and the consequently higher interest rates, Bell Canada recommends that the government reconsider its policy on the non-resident withholding tax as it applies to interest payments.

Your last sentence states:

> For interest payments to foreign lenders we recommend the elimination of withholding tax completely.

You give various reasons on the next page. Would you care to expand that, because your representations should carry a great deal of weight.

Mr. Wallace: Again we are speaking as a regulated utility, which implies two things: in the first place, our income is regulated and controlled by the regulatory body, as it should be. At the same time, we are in a period of a very rapid expansion in order to meet the public demand for communication services, which necessitates us going to the

capital markets for very large amounts of capital, roughly in the order of $200 million a year at the present time.

Because of the impact of regulation on our income and the necessity of attracting capital, our dividend payout has to be extremely high. Therefore, in order to alleviate the problem of raising capital we have had to appeal not only to the Canadian bond market, but to that of the United States.

In appealing to the United States bond market we find that the withholding tax is in many cases a problem which presents itself to the buyer of our bonds and perhaps in many cases eliminates them as prospective lenders. This has been increased due to the fact that we have had a number of proposals in the past from offshore countries with respect to prospective debt capital coming into the country, and the stumbling block is in all cases the 15 per cent withholding tax.

Senator Macnaughton: You make that point very well on page 6.

The Chairman: Senator Macnaughton, when Mr. Wallace is going all out for these corrections to make borrowing easier, is that suggesting some lack of confidence in what the full integration will produce by way of the equity capital being a more attractive form of investment?

Mr. Wallace: No, I think we have to rely on both the equity markets and the debt markets. The nature of our business is such that we would have to rely on both kinds of capital, and this again is affected by the regulatory climate in which we operate.

Senator Everett: Presumably what you are suggesting is that Canadian equity should be increased and foreign debt should be increased.

Mr. Wallace: To the extent that Canadian debt may become more expensive or more difficult to obtain because of the attraction of Canadian equities, we think there will need to be a greater reliance on the foreign debt markets.

Senator Everett: But it would be debt?

Mr. Wallace: It would be debt, yes.

Senator Macnaughton: And the elimination of your 15 per cent withholding would perhaps reduce the rates.

Mr. Wallace: Yes, because the impact of the 15 per cent withholding, particularly with respect to the offshore countries who have approached us, would be that we are increasing the effective rate which they will charge us if we have to absorb that tax ourselves by 15 percentage points.

Senator Phillips (Rigaud): Mr. Wallace, I find you very lucid but I missed your line of reasoning as to why the rate of dividend on your equity position must always be high. Would you mind repeating that? I lost the trend of thought.

Mr. Wallace: My thought was expressed, I think, this way...

Senator Phillips (Rigaud): Would you do it a little more slowly so that I can absorb it?

Mr. Wallace: As a regulated utility our income is naturally controlled to some extent by the limitations imposed on us by the regulatory authority, so that there is not the growth opportunities for our equities that there might well be in other industries. But because of our need to attract large amounts of equity capital, we have therefore to supply the shareholder with substantial dividends, which necessitates a high pay out of our income in the form of dividends.

Senator Phillips (Rigaud): Is not the offsetting consequence of that policy—I am not running the Bell Telephone Company—the necessity, for instance, at the present time of paying a very high rate of interest on funded debt?

Mr. Wallace: No, I think we are paying competitive rates on funded debts.

Senator Phillips (Rigaud): I know you are paying competitive rates, but you pay high dividends in order to attract equity capital, and in the process of paying out high dividends you need more money, and therefore you go out on the international market and pay high rates of interest.

Mr. Wallace: That is correct.

Senator Phillips (Rigaud): Is that the line of reasoning?

Mr. Wallace: That is correct.

Senator Phillips (Rigaud): I find it difficult to follow.

Mr. Wallace: I am saying essentially that we are restricted in the extent to which we can internally generate funds, so we are very

dependent on both equity and debt markets for our capital.

The Chairman: Mr. Wallace, in putting forward this restriction or amendment of the integration policy to the extent that the incentives reduce the amount of creditable tax available, you then go on to say:

> To prevent the same amounts being credited to shareholders at a future date, when the corporation actually pays the taxes previously deferred, shareholders will be required to reduce the cost or valuation basis of their shares by the amount of the dividend on which the tax was deemed to have been paid.

It seems to me that there are two things in there. One is, I would expect that a more normal way of dealing with that situation would be that in the year in which the deferred tax is paid, the creditable tax would be reduced, rather than to say that the cost of the shares would be reduced, because that would expose the owner of the shares to more in the way of capital gain, or might be likely to, whereas if the creditable tax were reduced because of that step he would still maintain his valuation cost.

Mr. Wallace: This might be true if you were dealing with the same shareholders at a future period. Of course, you might not be in that case.

The Chairman: Does it matter? We are dealing with a principle. Would not it have the same effect?

Mr. Wallace: We are concerned, of course, with principle, but we are also concerned with the reaction of 250,000 shareholders.

The Chairman: Oh yes, I see that. With regard to incentives, I did not construe incentives as really involving deferral of tax. I thought your plan was that corporate tax for purposes of creditable tax should be calculated excluding incentives.

Mr. Wallace: At the present time the particular item we are deeply concerned with is the capital cost allowance, which is an incentive form of tax relief to the corporation.

The Chairman: But there is no tax deferred in its application, is there?

Mr. Wallace: Oh yes.

The Chairman: How? I mean, you reduce your income by the capital cost allowances and the company pays less tax.

Mr. Wallace: It will pay higher future taxes, of course.

The Chairman: Only when it runs out of capital cost allowance.

Mr. Wallace: That is right.

The Chairman: But I expect yours is a continuous program, so that you are always generating capital cost allowances.

Mr. Wallace: We do not know whether that will always pertain.

The Chairman: As long as the population keeps increasing.

Mr. Wallace: I think the impact or the effect of capital cost allowance application is that it produces deferred income taxes, and I think this is expressed in the work papers of the Canadian Institute of Chartered Accountants, and it is dealt with in that form in all balance sheets. I think this is in fact a deferral of taxes.

The Chairman: The word "deferral" bothers me. I figure out that "deferral" means that there is something you are going to meet up with again with some day, and that is what I would regard as deferral.

Mr. Wallace: I think you do that with respect to any given set of assets. To the extent that you claim excess depreciation today you will get less tomorrow for that same set of assets.

Senator Everett: You are running on a straight line basis.

Mr. Wallace: That is right.

Senator Everett: That would be the very situation you are talking about.

Mr. Wallace: That is correct.

Senator Cook: I notice that last year you provided $170 million depreciation. In your brief you point out that paragraph 5.14 of the White Paper says:

> Nevertheless some have suggested that they are too generous, and the government believes that after 20 years of the system it is time for a review.

If there is a review of the capital cost allowances to make them less generous, say, that will leave less money in the hands of Bell Telephone and other companies.

Mr. Wallace: That is correct. It would create further need for external financing.

Senator Cook: Would you agree that tax reforms are not complete unless the Government also indicates how it is going to treat them?

Mr. Wallace: I think that is the point we are trying to make, that this should not be looked at in isolation. In order to fully assess the impact of the White Paper one must know what the Government's intentions are with respect to such things as capital cost allowances.

The Chairman: So even your approval of fully integration has that qualification as well.

Mr. Wallace: We would like to know what was going to be done, yes.

The Chairman: I think I understand. We were talking at cross purposes a few moments ago. I was talking about your tax accounting statements. There, of course, I assume you take all the allowances to which you are entitled to.

Mr. Wallace: We take maximum capital cost allowances.

The Chairman: But you also have a corporate statement which goes to the shareholders, and you may take less, in which event you have deferred taxes.

Mr. Wallace: That is correct.

Senator Everett: Your method of handling this tax, I gather, is dealt with in attachment No. 2.

Mr. Wallace: That is correct. Attachment No. 2 indicates the way in which this would operate.

Senator Phillips (Rigaud): Mr. Wallace, you made a very impressive case on the question of the effect of the White Paper being inflationary. Does Bell think it desirable to pay high dividends in order to attract equity stock and, if so, if that principle were followed by all Canadian companies, thereby reducing corporate profits for expansion and inviting foreign debt without withholding tax, would not that be highly inflationary in the result?

Mr. Wallace: I do not think it would be necessarily highly inflationary in itself.

Senator Phillips (Rigaud): If a series of Canadian companies at large considered it a matter of sound corporate policy to pay high dividends for the reasons you have mentioned in order to attract equity capital, and in the process also considered alternatively that it would be desirable to get foreign capital on a non-withholding tax basis, surely the accumulative effect of high dividend policy exercised by Canadian companies must be its nature be inflationary.

Mr. Wallace: You are quite right. I would not necessarily agree with the desirability of having high dividends. I am not advocating a high payout for other Canadian corporations.

Senator Phillips (Rigaud): I thought that would be your answer. I think a broad observation is needed and a bit of regulatory attention.

The Chairman: There is one other question on full integration that I would like to put to you, Mr. Wallace. It is part of the full integration proposal that you have the deemed realization provisions in force where there would be revaluation of shares every five years, and whether you sold them or not there would be a capital gains tax on the difference between your valuation date value and the five-year revaluation. Have you assessed how necessary that feature is to the success of the full integration proposed in the White Paper or could an operation preformed and that part severed without affecting full integration under the White Paper?

Mr. Wallace: I do not know if we have studied that sufficiently to make an observation on it. We certainly would not agree with the five-year revaluation where there has been no realization of a capital gains.

The Chairman: The purpose stated is that the integration proposals on the creditable tax are attractive to maintain and continue investments in shares. The capital gains tax at the rate proposed might make it more attractive for people to hold than to sell their shares.

Mr. Wallace: That is correct.

The Chairman: Therefore, since this would result from a White Paper proposal, it would then become necessary to unlock these people or separate them from their shares either fictionally or actually by revaluation every five years. This has been put forward in the White Paper itself as being necessary to prevent them from being locked in. It does not prevent them from being locked in if they continue to hold their shares and do not sell them. All that happens is that they are

assessed capital gains tax as though they had sold them. It would appear on that basis to be an integral part of the full integration plan proposed.

How the plan would survive without it may be open to serious question. How the plan would survive without the capital gains tax generally in the form in which it is proposed in the White Paper is also open to serious consideration, is it not?

Mr. Wallace: If that is indeed one of the requirements for integration then I think we must have had qualification with respect to our viewpoints.

Senator Everett: A propos abandoning the quintennial evaluation, do you not also state that it will only affect government revenues to the extent of one per cent of the total budget?

Mr. Wallace: That is correct. Whether or not that makes it impossible to consider integretation without such a proposal is something I am not in a position to answer.

Senator Everett: Clearly you do not think it is very significant.

The Chairman: Senator Everett, one per cent may sound very insignificant, but it depends on one per cent of what. We are talking about $100 million, which is the estimated revenue from this particular proposal.

Senator Everett: The bill says that this is a substantial sum, but less than one per cent of total federal and provincial tax yield.

The Chairman: You will remember that when Senator Phillips was questioning Mr. Bryce about the $650 million in additional taxes being generated by the White Paper in the fifth year, Mr. Bryce agreed with Mr. Phillips that it would come out of the savings of the people. Mr. Bryce's answer was that it was an insignificant amount in relation to all the amounts of dollars we were talking about, whereupon Senator Phillips said, "If I went to a bank with $650 million what amount of credit do you think I could generate?" The answer was, "Some billions of dollars." You have got to look at it relatively when you make statements of that kind.

Senator Everett: You have got to keep your sense of proportion. Dealing with that for a moment, on page 11 you make the point that it will be the small shareholders or the lower income shareholders who are going to suffer most from the quintennial revaluation.

Mr. Wallace: Yes, that could be if they are forced by virtue of implementation of capital gains tax to sell their shares. I would like to emphasize in reference to the Chairman's last comment that I do not minimize the importance of the $100 million. Being faced periodically several times a year with the necessity of raising $100 million, I know exactly what it is worth.

Senator Phillips (Rigaud): I would like to make one point, because I think we should get this into perspective. Mr. Wallace has given us an idea which may be useful. Even though I do not agree with his line of reasoning, it obviously led to the suggestion that we should eliminate the withholding tax in respect to debts that would be owned to non-residents. That brings up the whole question of the method of acceleration of foreign investments in Canada, and, an interesting inducement, particularly in countries where they have no tax credits and that sort of thing.

It could be that a suggestion of that kind, Mr. Chairman, might be put on our agenda in due course for consideration. When I read the brief I felt that that suggestion had value in an entirely different area—the whole business of bringing foreign capital into the country from the point of view of assisting expansion. Of course, if you should lose track of that as such without relating it to the subject matter of integration and the like...

The Chairman: I am just wondering how serious a matter is the withholding tax in relation to moneys borrowed in the United States.

Mr. Wallace: It has been somewhat of a handicap in that we know there are certain classes of lenders in the United States who will not buy our debt for the one reason of the withholding tax, either because they cannot claim an offset on their U.S. tax or they do not want to be bothered with the problems associated with it.

Senator Beaubien: If we could eliminate our 15 per cent and get the Americans to do the same, then the Canadian Government would not necessarily lose much money, because there would not be a withholding tax which would be deductible in the hands of Canadian recipients.

The Chairman: Ordinarily when interest or dividends are remitted to an American company by a Canadian company there is a withholding tax here, but there is a corresponding

credit in the United States to that person now.

Mr. Wallace: If he is taxable, yes. There are many non-taxable institutions.

The Chairman: He might be borrowing from pension funds.

Mr. Wallace: Pension funds, trust funds and so forth. It is just as well in this respect to mention that there has been a clear recognition of the importance of this. You will recall that two or three years ago there was an exemption of the 15 per cent withholding tax granted to the Churchill Falls (Labrador) Corporation to allow them to compete with the Americans and to compete more effectively with government institutions which were borrowing but which were not subject to the 15 per cent. That is a fairly important item.

The Chairman: Mr. Gilmour has something to say on the point of integration and the effect of these departures from the full integration as proposed in the White Paper.

Mr. Gilmour: Gentlemen, I have been listening to the heresy that is being spoken on integration, but equally I should like to point out that the major criticism of integration has been that it forces a corporation to pay out its profits to its shareholders so that they can gain the advantage of the corporate tax that has been paid. The converse of that is that there are no profits remaining to be ploughed back for further expansion.

For the ordinary commercial manufacturing company that is very vital. But the situation is different in dealing with the regulated corporations such as Bell Canada. Looking at page 10 of the financial statement of Bell Canada I notice that the balance of retained earnings at the beginning of 1969 was $177 million. The balance at the end was $202 million. The retained earnings in this particular year, therefore, were roughly $25 million.

Looking at page 7 I notice the charges Bell Canada had against its earnings. The interest charges that they had to pay were approximately $72 million, consisting of interest on long-term debt and others. The dividends they paid in the same year, as shown on page 10, amounted to $88 million. So that there was paid out of their earnings all told $160 million. When you look at the balance sheet shown on page 9 you will see that the shareholders' equity is capital stock—premium on capital stock—and the retained earnings are $1,466 million. Then there is the long-term debt of $1,262 million.

We can perhaps forgive our witnesses for their heretical statements, because they are in the position that they cannot, under regulation, plough back any earnings. Rather, if they want to expand, they do not do so out of retained earnings but, I expect, they expand out of additional capital stock and additional bonded indebtedness.

I do think there is an important distinction to be drawn between the relatively few regulated companies in which integration really gives their shareholders a benefit without hurting the corporation itself and most of our corporations where the situation is the reverse.

That was the reason why the British dropped integration, of course. As they pointed out, it discouraged companies from ploughing back profits. And, too, it would have been the perpetuation of a tax system unique to the British at that time, which was holding back foreign investments in Great Britain or holding back admission into the common market.

For the vast majority of companies we should point out the ill effects of integration, but for regulated companies perhaps there are some virtues.

Senator Molson: Mr. Chairman, I should like to ask Mr. Wallace and the other officials of the Bell for their opinion of the principle involved in defining small corporations in terms of the lower or split tax level. Many people have suggested that small corporations should be defined so that they would get the corporations should not get the benefit of it.

Mr. Wallace: Although it has no direct bearing on Bell Canada, we have indicated in our general comments on the economic consequences of the White Paper that we do not approve the elimination of the low tax on small corporations because of its impact on them and because it will discourage corporate saving. We think there is a need to define small corporations and to continue the low rate of tax on their behalf.

Senator Carter: Mr. Wallace, this morning you made a point concerning the short life of your plant equipment and the depreciation allowances not being adequate. What is the average life of the plant?

Mr. Wallace: I did not wish to imply that our plant life was necessarily short. The average life of the plant is in the 20-year range. But while the straight line depreciation rates we use in our corporate accounts will amor-

tize the cost of our plant over 20 years, the rates provided in the Income Tax Act for capital cost allowances do not in fact do that. The life of the plant in so far as its writing-off is concerned is extended well beyond its physical life. For this reason we believe the capital cost allowances as prescribed for telephone plants are totally inadequate.

Senator Burchill: Mr. Wallace, do you recommend two rates for capital gains tax, a short and a long?

Mr. Wallace: We feel that, if we are going to have a capital gains tax, there is a requirement to distinguish between short-term gains, which are realized from trading or from speculation, and long-term gains, which are of a different nature. We would certainly recommend different treatment.

The Chairman: The short-term is what I been calling the "fast buck".

Mr. Wallace: That's right. And they should be subject to tax.

The Chairman: Any other questions?

Senators, the Senate meets at 2 o'clock so I propose that we should meet here again at 2.30 when we will hear the remaining brief from The Canadian Chemical Producers' Association. Is that agreed, honourable senators?

Hon. Senators: Agreed.

The committee adjourned until 2.30 p.m.

Upon resuming at 2.30 p.m.

Senator Lazarus Phillips (*Acting Chairman*) in the Chair.

The Acting Chairman: Honourable senators, the law of averages, as on the stock market, it has caught up with you and I am your Chairman this afternoon.

This afternoon, as you know, we are hearing from the Canadian Chemical Producers' Association. I have the pleasure of introducing the following gentlemen to you. Mr. C. S. Malone is on my immediate right, and he is the President of Chemcell Limited. Next to him is Mr. C. A. Brooke, the Manager, Tax Department, Domtar Chemicals Limited. Next to him is the man who came to dinner, whom we do not seem to be able to get rid of, Mr. D. A. Macintyre, the assistant Manager, Tax Compliance, Imperial Oil Limited. To my extreme right is Mr. B. F. Macdonald, President of The Canadian Chemical Producers' Association.

My understanding is that Mr. Malone will start off by following the usual procedure that we have indicated by making an opening presentation. Is that agreed?

Hon. Senators: Agreed.

The Acting Chairman: Would you be good enough to start, Mr. Malone?

Mr. C. S. Malone (President, Chemcell Limited), Member, The Canadian Chemical Producers' Association: Thank you, Mr. Chairman. Honourable senators, I would first like to expess our appreciation of this opportunity to appear before you today. We believe these public hearings are a constructive innovation which will help to improve the Canadian legislative process.

Subject to your agreement I propose to make a very brief opening statement, and thereafter I assume you will wish to question us on the details of our views as contained in our brief. Let me start with a few words about the Canadian Chemical Producers' Association.

The C.C.P.A. is comprised of 42 member companies whose plants are located from coast to coast, and represents the great majority of firms in the "heavy" or "industrial" chemicals sector of Canada.

There are over 1000 chemical plants of all kinds in Canada; total assets approximate $2.5 billion; some 75,000 people are employed; wages approximate one-half billion dollars annually and the level of these wages is almost 20 per cent above the national average.

The Canadian chemical industry output approximates 6 per cent of all manufacturing, we pay some 8 per cent of all the income tax derived from manufacturing industries and stand fourth from the top among the 20 leading industrial tax payers.

You will see that tax policy is of crucial importance to us.

Since 1966 the returns on investment in the chemical industry have been dropping and the balance of trade in chemical products steadily worsening. The essentiality of a healthy chemical industry gave rise to a government study, in co-operation with industry, which took two years and was completed about one year ago. This study has never been made public, but the Minister of Industry Trade and Commerce has announced the major findings. We have problems of scale, problems of foreign market access and a small fragmented domestic market. In short,

we are an industry in an evolutionary stage due to technical advances which have made large scale plants and low unit costs mandatory to be competitive in world markets. Canada's tax policies contribute to our high costs and difficult competitive position, and the White Paper proposals, if implemented, do nothing to help, and will probably worsen our position.

Ours is a capital intensive and high technology industry, and its productivity, estimated on the basis of the "valued added" concept, is some 55 per cent greater than the national average. This serves to illustrate a point of major economic significance. We believe it is industries such as ours which will enable Canada to derive maximum benefit from its natural resources; it is industries such as ours that will employ the engineers and technologists whom we are now educating in large numbers.

Our share of the domestic Canadian market is falling. The trade deficit in chemicals has risen from $249 million in 1965 to $309 million in 1969, and it is estimated that it will reach $500 million before 1975. In the fastest growing field, that of plastics, we last year had only 59 per cent of the Canadian market.

So much for the industry environment. Let me now turn to some of the White Paper proposals. We believe you will want to hear our views on those sections which particularly affect our industry.

In our opinion, the first priority should be the creation of an economic environment which encourages more saving, and more investment as a means of enlarging our economic and taxation base. I suspect that most of your witnesses have expressed similar views, so I will not burden you with further comment in this regard, although naturally we would be happy to answer questions.

Government policy knowledges the need to spur selected economic activities but the proposals seem to run contrary to the policy inasmuch as they minimize national savings, reduce incentives by taxing capital gains at high rates, dampen investment enthusiasm by suggesting that capital cost allowances are too high, continue the high effective tax burdens on corporations relative to many countries and lessen the incentives to invest in small businesses. One if forced to the conclusion that our Government either does not understand what is necessary to stimulate industry or is unconvinced of the need.

The White Paper is proposing a massive change in tax structure and we are concerned that it may further dislocate our economy. Moreover, it is our view that some of the proposals are likely to reduce the motivation of key personnel to produce and their ability to save. In addition, the ability to transfer key people across international boundaries is particularly important in a high technology industry such as ours, and several of the proposals will inhibit this flexibility.

The effect of the proposals on Canada's ability to accumulate investment capital is a major cause of concern. We believe domestic savings will be reduced, as will the incentive to save and, at a time when there is a world wide shortage of capital, Canada appears intent upon introducing legislation which, in our view, will reduce our ability to attract foreign funds. The potentially serious effects of these developments is readily apparent if one considers that it takes, on the average, a minimum of $15,000 of invested capital to create a single new job. In the chemical industry, by virtue of its high technology, this figure frequently runs in excess of $60,000 per job.

In summary, it is our belief that major fiscal experimentation is both unwise and unnecessary.

I may add, at this particular time of troubled capital markets, not only in Canada but in many areas of the world, the advisability of experimentation is wiped out.

The Acting Chairman: Thank you Mr. Malone. Before honourable senators put their questions to you, I think they will be interested in knowing a little more of the background of your difficulties in terms of the competitive aspects. What are the countries that are causing most trouble competitively to you? Is it due to costing problems, or is it due to knowhow, or a combination of both? Before we get into your specific problems maybe we should know a little more about the hurt and where it comes from.

Mr. Malone: It is a relatively complex situation. Others may wish to add certain things to what I am going to say. In the late 1950s there was a Tariff Board Review of chemical tariffs. This was conducted through to the early sixties and new tariff rates were recommended by the Tariff Board substantially lower than the previous rates, and also in organic chemicals about 50 per cent of the rates prevailing in the United States. These rates were used in negotiations in the Kennedy Round and they were bound under

GATT and brought in at one particular time when the Kennedy Round was implemented.

At the same time there was a vast change in technology going on in the chemical industry where large-scale plants were being developed with low-unit costs. We found Canada giving up its protection and not really getting access to the United States market when technology was changing. We were being put in a very non-competitive position.

Senator Beaubien: Are you saying taxes are a great deal higher going into the United States?

Mr. Malone: Tariffs on organic chemicals are roughly double.

Just after the Kennedy Round rates the Government induced a study of the chemical industry. I think the industry is to blame for not having worked more closely with the Government at the time of the Kennedy Round discussions, and not recognizing the changes in the technology. The change in technology and the reduction of domestic tariffs have hurt the chemical industry very much during the past four or five years.

The Acting Chairman: Have you had any subsidy problems from European exporters from, say, Germany and Japan, into Canada?

Mr. Malone: Our main imports have been from the United States and European Economic Countries and, to some degree, Japan. Most of these countries have much larger domestic industries with a much larger normal market. Canada's market for chemicals is static in most cases, and therefore their unit costs are a lot lower than ours.

When you deal with Germany, which has a different tax structure and relies more on indirect taxation than direct corporate taxation—these countries get a rebate on their indirect taxation for exports. They are therefore in a competitive position.

This subject was brought up this morning in the discussion with respect to direct taxation and indirect taxation. Countries with a tax structure which relies on direct taxation do have a competitive position in export markets.

The Acting Chairman: What is the specific proportion of your domestic sales to export sales in a given year?

Mr. Malone: I do not think the figures for our association are that great.

Mr. B. F. Macdonald, President, the Canadian Chemical Producers' Association: No.

Mr. C. A. Brooke, (Manager, Tax Department, Domtar Chemicals Limited), Member, the Canadian Chemical Producers' Association: I believe the latest Dominion Bureau of Statistics figure was something of the order of $10 million a month in exports compared to about $190 million a month production.

The Acting Chairman: So you are essentially a domestic participant.

Senator Benidickson: Mr. Chairman, I think it is easy to appreciate competition with respect to scale. You refer to that in your summary. A few minutes ago you indicated that you achieved competition with the United States. In your brief you make reference to scale, but also say that high taxation is an important factor contributing to the poor competitive position of a Canadian chemical industry in world markets. How does the corporate taxation with respect to your Canadian industry compare with similar industry in the United States?

Mr. D. A. Macintyre (Assistant Manager, Tax Compliance, Imperial Oil Limited), Member, the Canadian Chemical Producers' Association: As a starting point, senator, as our brief says, the federal corporate rate in the United States is 48 per cent. In Canada we are looking at a combined provincial and federal rate somewhere in the order of 52 or 53 per cent, and perhaps higher under the White Paper. The 48 per cent United States rate admittedly does not include state taxes, but I think it is well known that the bulk of the United States federal chemical industry is located on the Texas Gulf coast, and Texas does not have a state tax. In addition, we must recognize that there are inter-relationships, international companies involved here, and, as the brief points out, the international investors scan the horizon. By the time you take into consideration the withholding tax on earnings flowing from a Canadian plant to those of a United States plant, the relative attractiveness of Canada is even lower. Tax, and I am sure Mr. Malone will emphasize, is not the only factor. The scale is probably the major factor, but taxes are certainly a factor in terms of assessibility to market.

The Acting Chairman: Mr. Malone, I would like to go to page C.17 and deal with your analysis of the White Paper under two headings. The first is the evidence which your

organization considered undesirable. Secondly, I hope with the co-operation of honourable senators to see whether there are any salvage aspects of any items which might well be accepted either as indicated in the White Paper or as modified.

On page C.17 we start off with what we previously called in this committee the hard core of the White Paper, that is the integration approach. As I see it, your organization takes the position that the proposals to integrate personal and corporate taxation introduce unnecessary complexities and that the disadvantages far outweigh any advantages which might arise therefrom. In order that we may use to advantage the time at our disposal may I take it that this committee can conclude that your organization is against the integration system as contemplated by the White Paper?

Mr. Malone: You may, Mr. Chairman.

The Acting Chairman: Having done so we move on and take the last part in the integration heading at the bottom of page C.7 where you say:

> In contrast, we feel that the form of the present dividend tax credit system, which is simple, workable and easily understood, could be enlarged to provide an increased incentive for Canadians to invest in Canadian equities.

In dealing with the present dividend tax credit system, those who have appeared before this committee have taken the position that they are either satisfied with it or would suggest increasing it from 20 per cent to 25 per cent or even to 30 per cent. Have you any other suggestions with respect to the improvement of the present dividend tax credit system?

Mr. Brooke: There are further complications that could be built into the present dividend tax credit system which might meet some of the objections that it favours the high income person over the low income person. However, I doubt that the value of the increased complexities outweigh the simplicities of the present system.

The Acting Chairman: Do you suggest that one should not tamper with it at all, or if we leave it as it is, to what extent?

Mr. Brooke: I would suggest 25 per cent.

The Acting Chairman: That covers that point. I am assuming none of your associates have any other thoughts on the subject.

May we move on from there and get the the benefit of your views on how you feel about the treatment of small business and whether you believe small business should be entitled to a preferental rate. Would you help us in coming to some conclusion as to what could be defined as a small business?

Senator Aseltine: The chemical industry would not have any small businesses as far as I can see.

Mr. Malone: We have a number of members, senator, who are small business people, and a number of our customers are quite small business people.

Senator Aseltine: Businesses with a taxable income of less than $100,000?

Mr. Malone: Yes.

Senator Benidickson: You said 42 members?

Mr. Malone: Yes.

The Acting Chairman: Will you deal with the subject, Mr. Malone?

Mr. Malone: I think a number of us will deal with it. We have tried to come to grips with some definition of small business but I do not think we have been too successful. There have been thoughts expressed that it should be based on taxable income. This is one way, but I am sure there are certain abuses to that. Others have expressed the view that it should be based on assets. Personally, I do not know how to come to grips with a proper definition. Mr. Macintyre may have other thoughts on that.

Mr. Macintyre: I think I will defer to Mr. Brooke.

Mr. Brooke: Mr. Chairman, the big problem as I understand it with the current system is that there is allegedly a lot of abuse of this low rate of tax by splitting up companies into very many small synthetic parts. I work for a very large company, and we have not found any way of splitting our operation up into very many parts. We only get one exemption, and I think this is true generally speaking of most business. Perhaps some small businesses are genuinely able to do this, but I would say whatever one's definition of a small company is going to be, there is always going to be

some definition problem related to the operation of this and the enforcement of these rules, and I think part of the department's desire to get away from the current divisions is going to be defeated by any alternative provisions that come in. I think we all accept that there is a need for a small company to be able to retain the capital which is its only source of new funds, and a suggestion that we have heard, which, I believe, was put forward by Shell in their brief to this committee appears to be as good as any other that we can see. I can immediately see a lot of ways of abusing that as well for the reasons I have just outlined, but they have a very real problem, and that would be the best that we have seen. But I do not think that we as an association would recommend it. We do not have enough knowledge of the problems and the abuses to answer that question adequately.

The Acting Chairman: But the degree of the expression of your opinion is concurrence in the concept that that which is ultimately defined as a small business should receive special rate consideration.

Mr. Brooke: I think one of the advantages of the Shell definition, as I find it, is that you do not need to define a small company. It depends on the extent to which they pay out dividends. The companies define themselves in that sense.

The Acting Chairman: Would you care to develop that?

Mr. Brooke: Maybe I had also better be a little careful. I have also seen a brief of another association which has not yet appeared before you.

The Acting Chairman: I do not quite remember a definition that related itself to the distribution of earnings. Would you develop this for ht ehonourable senators because it is a new concept.

Mr. Brooke: The proposal that I heard in this context was that there would be a deferral of tax on a certain amount of income up to a limit, and this deferral would be lost in relation to dividends paid out. In other words, a small company that was prepared itself not to pay out dividends, would also be able to defer taxes and retain that within the corporation. There would then be a relationship between the deferral and the distribution.

Senator Haig: On page 2 of your opening statement you say that your association "is comprised of 42 member companies whose plants are located from coast to coast and represents the great majority of firms in the "heavy" or "industrial" chemicals sector."

Mr. Malone: Well, there are a lot of companies in the dye stuff industry or in the so-called fine chemical industry who are not members of our association.

Senator Haig: What is a "heavy" or "industrial" chemical?

Mr. Malone: In most cases a bulk chemical. For example, primary building block chemicals such as ethylene or caustic soda or chlorine and things of that nature.

Senator Haig: Do your firms or firms who are members of your association make the chemical used on railroad rights of way to break up the weeds?

Mr. Malone: Yes, some of them would.

Senator Haig: That is a heavy chemical?

Mr. Malone: It is pretty hard to break down the chemical industry because a lot of the firms make the primary products and make the advanced products also. But the bulk of our firms are in the heavy chemical business.

Mr. Macdonald: The primary chemicals are the chemicals which are made in vast quantity and are sold at commodity prices. There are the building blocks from which all these finer specialty chemicals are derived.

Senator Kinley: Do you make antibiotics?

Mr. Malone: No, that is the pharmaceutical industry.

Senator Kinley: Do you make paint?

Mr. Macdonald: Some companies who are members of the Canadian Chemical Producers Association do make paint, but they are not assessed fees on the basis of their paint manufacture. They also belong to the Canadian Paint Manufacturers' Association.

Mr. Malone: To be a member of our association, you have to make a product involving a chemical change. That is a prerequisite.

Senator Kinley: Talking about this weed killer, do you also make insecticides?

Mr. Malone: Some of the firms do, yes.

Senator Kinley: A bill was passed in the house nearly two years ago which has not been proclaimed yet. It was rather a drastic bill with high penalties for the farmer who used the wrong type of weed killer. I have inquired lately and as I say I find it has not yet been proclaimed. Do you know about that?

Mr. Malone: I personally do not know about it, but some of our member firms may.

Senator Kinley: Do you make those insecticides such as moth killers and the two or three other things used mostly by farmers? DDT, of course, I suppose you would use that?

Mr. Malone: My own firm does not, but some member firms do. Imperial Oil is partially in the insecticide—fertilizer business. Some of the firms in our industry would make the starting materials for those products.

Senator Kinley: Do the pharmaceutical people go to you?

Mr. Malone: No, they do not, sir.

Senator Haig: Imperial Oil makes ENCO.

Mr. Macintyre: ENCO is the brand name. We have a large fertilizer manufacturing facility. Perhaps I could give some other laymen's examples—and compared to Mr. Malone or John Macdonald I am really a layman in this business, in the chemical. I think the message here as to the products that the members of this association make would be the raw plastics from which other people make garbage bags, plastic bottles, fibres, the synthetic rubber in bulk quantities. I think this is a general categorization of the type of products.

Mr. Brooke: Raw materials that other manufacturers use in their manufacturing process.

Senator Kinley: What research benefits do you get from the government for creating new products? What do you get? Is it 110 per cent of the wage scale?

Mr. Brooke: There are several government incentive programs. In general I would say that we get very little out of it, largely because of the structure of the earlier programs at this point, which is based on the history of five years' expenditures, and you only get an incentive on the excess overlap. We have got rather little out of that. The other main one that has recently been changed, which may now be of more use to us, we have not really assessed. At this point in time we get very little research incentive benefit in my company, but I cannot speak for the association as a whole.

The Acting Chairman: Now, gentlemen, would you be good enough to move to page B.2 of your brief. Following a proposed plan we have disposed of integration and small businesses, at least for the purposes of this hearing, and I would like to go to your references to the proposed capital gains tax. You say:

> CCPA believes the relative immaturity of the Canadian economy compared to the United States suggests that the introduction of a full capital gains tax at this stage in our development is inappropriate.
>
> CCPA believes it is fundamentally wrong to tax capital gains before they are realized and therefore opposes the proposed quinquennial evaluation procedures.
>
> If Canada must have a capital gains tax CCPA suggests that it apply only to realized gains and at significantly lower rates separate from normal income and with an adjustment factor for inflation.

There are two questions I should like to ask, and no doubt other honourable senators will wish to ask more. The first is: on the assumption of a special rate, what rate do you suggest should be applicable to capital gains? Secondly, what type of exemptions do you have in mind as being fair and equitable? In other words, what exemptions would cover cases where the capital gain should not apply.

Mr. Malone: We feel if there is to be a capital gains tax—and we are not advocating one—there should be a distinction between short and long term capital gains; that capital gains dut to speculation or short term trading could be taxed at a rate more than the general taxation rate—let us assume, say, somewhere between 15 and 30 per cent—and that long term investments should in all probability not be taxed. What we are saying essentially is that if there is to be an introduction of capital gains tax, it should be on a gradual basis and not all at one time.

The Acting Chairman: With a maximum rate of how much, flat?

Mr. Malone: I would say, personally, 25 per cent.

The Acting Chairman: Would that be the thinking of your colleagues, that the maximum rate escalated upwards should not exceed 25 per cent? Is that your view?

Mr. Malone: Yes, Mr. Chairman.

The Acting Chairman: Have you any thoughts on exemptions?

Senator Hays: May I ask a short question on capital gains? What is capital gain in your opinion? What are you talking about?

Mr. Malone: I have been referring to capital gains on security appreciation.

Senator Hays: Anything else?

Mr. Malone: No, just on securities. Not on the sale of your private residence or personal effects.

Senator Hays: So you interpret capital gains as just the increase on stock investments.

Mr. Malone: That is right.

Senator Hays: Period.

Mr. Malone: Period. That is my personal view.

The Acting Chairman: What are the views of the other gentlemen on that point?

Mr. Brooke: I would feel that the taxation of capital gains on small items, or most personal items, will lead—and this is my personal view, not the association's view—to a large measure of tax evasion by individuals, who will not report all their sundry little items that are involved, and this will lead to a deterioration of the tax system rather than an improvement.

The Acting Chairman: What is the answer to the objection that if we tax only capital gains investors will divert their funds to, say, the purchase of pictures, homes and other commodities than securities? Is there not that danger?

Mr. Brooke: I do not really think that is a realistic objection. In fact, most of these things are marketable to a very limited degree. The appreciation in price of many of them—pictures may be an exception to this point—has been very much inflationary rather than anything else; it is a re-statement of the price in current dollars, and that is not a capital gains tax, that is a capital levy so far as tax applies to that.

The Acting Chairman: In the sales of securities do you draw a distinction between private companies and listed companies, publicly listed companies? Do you apply the capital gain on the profit realized on all securities whether listed or not?

Mr. Brooke: In our view as an association we do not agree with the integration proposals. We do not see the need to distinguish between widely held and closely held companies at all. If you need a distinction you can have a distinction of the partnership option, which effectively limits that, and then there would be no need for distinction in a capital gains tax.

Senator Everett: What about the profit on the sale of real estate?

Mr. Brooke: I think the sale of real estate—and I am sure real estate dealers would disagree with this—falls into two categories—those in which it is a business and those in which it is not. If it is a business, I think the need for any special rules does not exist in any case.

Senator Benidickson: Because it is taxed now anyway.

Mr. Brooke: That is right.

Senator Everett: And if it is not a business?

Mr. Brooke: If it is not a business I do not see the need to complicate the whole tax structure to bring all real estate gains that are, again if it is not a business, pretty ad hoc into taxation.

Senator Everett: I am sorry, I did not follow your articulation there.

Mr. Brooke: I am sorry. If the gain from the sale of real estate is not part of a business transaction, I do not see the need to bring that into taxation. The amount of gains that will be realized by that outside of business will be somewhat limited.

Senator Hays: But you think it is a capital gain?

Mr. Brooke: There will be some capital gain arising from it, yes.

Senator Hays: All the people who come before this committee are interpreting capital gains entirely differently. From my observation, some feel they are going to adopt the American system, and nobody knows what they will adopt.

Mr. Brooke: The White Paper proposals are very comprehensive.

The Acting Chairman: Senator Hays, I think what these gentlemen are saying is that if it is a short term acquisition of the disposition of a capital asset it goes into ordinary income. If the acquisition and disposition can be assimilated to inventory it is a business transaction, and hence ordinary taxable income. All other dispositions of capital assets could be identified, or properly described as involving capital gains. But, from the point of view of administrative complexities the suggestion is that the only capital gains profits that should be subject to tax are profits made in respect to the acquisiiton and disposition of shares or other types of securities than either private or listed companies.

Senator Hays: A great deal will depend on how the Government defines capital gains.

The Acting Chairman: That is another matter. For the moment these gentlemen are saying that instead of having a capital gains tax with exemptions such as we have been considering for farms or private assets valued under $5,000, that if there is to be a capital gains tax it should be escalated to a rate not exceeding 25 per cent of the profit made, and not including an income and confining it to securities.

Senator Everett: There seems to be a complicated aspect with respect to what constitutes business income. Let us deal with the real estate transaction you have been talking about. What rules do you propose to employ that separate business income from capital gains?

Mr. Brooke: I would think that the court decisions have clarified that rather well at this point.

Senator Everett: I would differ with you on that. That seems to be one of the worst jungles we have in the whole present tax system.

Senator Hays: I feel the same way about that.

Senator Everett: There is no clarification and the department is very reluctant to give rulings on it. It would seem to me, not being critical of your proposal but more to understand it, that one of the concomitants would be that you would have to define more clearly what is business income. Indeed, if we are making suggestions to the Department of Finance we should not fall into the trap of leaving it up to the department or to the courts to decide what is business income.

Mr. Brooke: My personal comment is that the proposed cure is much worse than the ill. There are always definition problems, and there always will be wherever you draw any line. To say we will therefore draw the line outside the country does not solve the real problem.

Senator Cook: When the question of intent comes in you cannot have flexibility.

The Acting Chairman: We are into the question, as Senator Everett put it, of whether you can get a definition of what is a capital asset, and whatever that is must be distinguished from what is inventory. The real issue is not what is taxable income and capital gains but what is a capital asset and what is deemed to be the inventory of a person. If it is inventory, the sale therefrom brings taxable income. If it is a capital asset and not inventory related to the business operations, then the profit produces a capital gain. I think that is a highly technical question, Senator Everett, that we should not expect these gentlemen to help us on. I think we are more concerned with getting their opinion as to whether there should be a capital gains or whether there should be an escalated rate and whether it should be restricted to a particular category of capital assets.

Senator Everett: I agree with you, but I do have more faith in their capabilities than you have.

The Acting Chairman: In the capability of these gentlemen?

Senator Everett: Yes.

The Acting Chairman: I am afraid they will give an answer which I do not like.

Senator Hollett: You raised the question: "Isn't that a danger?" This was in regard to capital gains and the building of homes. What did you mean by that and where is the danger? Would it not be a wonderful thing to put the capital gains to work on such things as buildings rather than have the Government take it over? I do not quite understand what you mean by "danger".

The Acting Chairman: Senator Hollett, we are discussing whether or not we should have a capital gains tax. We have been dealing generally with exemptions. Now we have gone a little further and we are at least dis-

cussing with these gentlemen the elimination of all taxation in respect to capital profits made other than from the sale of securities. In other words, if you sold a home or a farm or personal effects there would be no tax liability involved at all.

Sentor Hays: I would like to go back and ask another question about small businesses. We discussed small businessmen. Incidentally, I think that is a bit of a misnomer, because actually we are talking about companies with small profits. It may be the Imperial Oil Company that made $20,000. That particular year he is a small business. I think we should not confuse these two things, because really the small businessman is the fellow who owns a grocery store, for instance, and he is not incorporated.

I think the White Paper says that if they are going to take away something that all corporate bodies have had, it will be the 21 per cent on the $35,000. I think we should define small businesses instead of saying those with small profits.

The Acting Chairman: Except that the White Paper says what you say it says, and this committee has been considering a recommendation that would deviate from that conception.

Senator Hays: We are trying in this committee to define a small business.

The Acting Chairman: That is correct.

Senator Carter: Your association comprises 45 members. Most of these would be small businesses, would they not?

Senator Haig: Imperial Oil is not.

Senator Carter: You have some small businesses.

Mr. Malone: Yes.

Senator Carter: We are trying to get at what Senator Hays was trying to find out. How big would a business have to be in order to be able to borrow money in the capital market instead of having to build up its own capital reserves?

Mr. Malone: I wish we had an investment banker here. I do not know how big it would have to be in order to borrow in the investment market. A lot of companies borrow money in the investment market before starting into business, and this has happened in the past three or four years.

Senator Hays: Some never start.

Mr. Malone: It is pretty difficult to give a definition as to how big a company must be. I think it has been shown that small companies with a relatively low profit potential have difficulty in borrowing permanent money in a capital market. It is very difficult to say exactly how big you have to be.

Senator Aseltine: Or how little.

Senator Kinley: The best definition of a small business is the suggestion that if it has a profit under $100,000 it should be regarded as a small business. I think that was one of the best suggestions we have had yet on small businesses.

The Acting Chairman: Are there any further questions on small businesses or capital gains?

Senator Haig: Do you have an annual meeting?

Mr. Malone: We do.

Senator Haig: Is it educational or social?

Mr. Malone: Mainly educational. The wives are not invited. It is mainly a business meeting.

Senator Hays: That might make it work?

The Acting Chairman: May we proceed?

Senator Kindley: Why is the trade balance against you growing?

Mr. Malone: Because industry is not expanding in relation to demands.

Senator Kinley: In plastics?

Mr. Malone: In some countries, yes.

Senator Kinley: Are not plastics your greatest competitor?

Mr. Malone: Plastics are part of the chemical business but in the starting point in plastics, the raw materials, the scale of technology is changed to such a degree that you need large plants to be able to get the low unit cost for your starting materials, and Canada is not in a competitive position to build the large plants, and that is why you are having more of your plastic products being imported. You have to make money in your business.

The Acting Chairman: May we go to the next question? If so, I woudd like to put the following points before you. This committee is

bothered by the following problem; the White Paper speaks of taking off the payrolls some 750,000 taxpayers in the very low income brackets, at an estimated cost, we are told, of some $35 million. There seems to be reasonable unanimity that this should be done. Then the White Paper further says that it is proposed to increase exemptions for single people to $1,400 and for married people to $2,800 which would involve a loss of approximately $1 billion to the treasury, and in the process the replacement of income is moved over to the so-called lower middle income brackets. Now there seems to be considerable concern expressed to the citizens of this country both corporate and individual on this proposed suggestion. May we have your views on that?

Mr. Brooke: I think so far as the association is concerned we readily concede the need to abate the burden on the lower income groups. The problem then is where do you raise the additional revenue from? One other point that we have made is that perhaps there should be a shift from income taxes, including corporation taxes in general, to direct taxes which by their selective nature can avoid the necessities of the lower income groups. The other alternative is for the government to take growth policies that will stimulate the economy, give it a better tax base and therefore higher revenues and try to reduce what is now becoming an extremely high take by the government of the GNP of the country.

The Acting Chairman: Do you see any particular necessity or demand for increasing the exemptions from $1,400 a year across the board and $2,800 a year for married people and bringing about that loss of $1 billion and shifting to another segment of the people?

Mr. Malone: I think in so far as it immediately increases the marginal rates of everybody just above that level, this is a bad thing to do.

The Acting Chairman: A bad thing?

Mr. Malone: But I have some sympathy with upping those rates. $1,400 does not compare that favourably with $1,000 in 1949 in current purchasing terms. I think there are some real problems in here that we as an association have not looked at particularly.

The Acting Chairman: So you have no settled viewpoint on that, I suppose.

Senator Everett: Following on from what you have just said and dealing with part C 3, page C-14 of your brief, you make the point there that greater consideration should be given to an increase in indirect taxation and a consequent decrease in direct taxation, is that correct? Now I gather that first of all that would have the effect of making Canada's exports more competitive.

Mr. Brooke: That is correct.

Senator Everett: It would also have the effect of making Canada a more attractive place as far as investment is concerned.

Mr. Macintyre: Investment of international capital, yes, that is correct.

Senator Everett: And thirdly it would have the effect of taxing the lower income groups on a much fairer basis. Is that correct?

Mr. Macintyre: I think to the extent that a new equilibrium were struck between the lower corporate taxes and selectively increased internal taxes that the so-called regressive impact of indirect taxes could be largely mitigated. There might be some imbalances in shifts, but in the main I think that is true. France, in order to assist its domestic industry to be more competitive internationally, imposes a selectively based value-added tax that I think is of the order of 25 per cent. Canada, as you know, senator, has a selective federal sales tax right now. It happens to be 12½ per cent on most commodities and 11 per cent on building materials and there is perhaps more room to work in selective applications of indirect taxes to mitigate any hardship that might arise. But your general thesis that it would improve our competitive position internationally is very correct.

Senator Everett: Do you think that in the overhauling of the tax structure greater consideration should be given by the government to such indirect taxes as value-added taxes?

Mr. Macintyre: Yes, without explicitly saying what sort of indirect taxes there should be, our brief so states, senator.

Senator Everett: Do you think that in making the report of this committee that that is one of the conclusions the committee should draw from the evidence presented before it?

Mr. Macintyre: I think the committee should give very serious consideration to this. There are other examples in the world where

a conscious policy of government to attract an investment and to build a large industrial base, whether it be steel or chemical or otherwise, works very effectively. Belgium is a very good example. I can expound a little on that if you wish.

Senator Benidickson: Has it any reference to the following pages with respect to the competitive disadvantages where you say that a little bit of the tax haven would be a good thing? Is that your point?

Mr. Macintyre: Yes, senator. I think we can make a case in Canada for lowering the corporate rate directionally down towards 40 per cent. I think if it got below 40 per cent and having regard to the segment of United States investment in Canada, that any further lowering of the Canadian corporate rate would really mean the shifting of funds from Ottawa to Washington. It would be going beyond that which is necessary to equalize things from a US foreign tax credit point of view. But I think you can make a good case for lowering the Canadian rate down to the mid-lower 40 per cent range, and I should emphasize the combined federal and provincial impact.

Senator Everett: The argument opposed to that would be that this imposes an unfair burden on the consumer. Do you think that is a valid argument?

Mr. Macintyre: I suppose if one has a complete monopoly position, senator, whereby tax reductions were not passed on to the consumer, that would be theoretically valid, but I think at least in the mid-term and clearly in the long run that equilibrium would be reached where competitive forces would not burden the consumer.

Senator Everett: I suppose it is true to say that high corporation taxes are passed on to the consumer on a non-selective basis?

Mr. Macintyre: On a non-selective basis; certainly long run, put it that way.

Senator Everett: You have given your personal view. Is it the general view that the committee should consider this in its report and recommend this approach to the Government? Is that the general view?

Mr. Malone: It is the view of the industry association, yes.

Mr. Macintyre: And stated in this brief.

Senator Cook: Are capital cost allowances important to this industry?

Mr. Brooke: Yes, they are extremely important. It is a very capital intensive industry, and capital cost allowances are of extreme importance to us. They are almost of more importance than minor changes in the tax rate.

Senator Cook: Therefore, if the Government were to reduce these, or, to use their own terms, make them less generous, that would have the effect of increasing the Government's slice of the cake from the members of your industry?

Mr. Brooke: That is right. It would make investment in the industry distinctly less attractive.

Senator Cook: Would you agree that tax reforms are not complete unless the Government also indicates how it is going to treat them?

Mr. Brooke: That is correct.

Senator Cook: On the question of complexity, which is a matter of concern to a number of us, in section B-3 you say:

> The CCPA suggests implementation of the White Paper proposals will produce a complicated tax system which will result in administrative costs out of proportion to the added revenue collected. This will discourage investors who may take their investment elsewhere.

You elaborate on that in your comments on page C-17. Would you further elaborate that or read your comment into the record? I think it is very important on the question of complexity. Most of us find it difficult enough now to make up our income tax returns. I gather this would add greatly to the expenses of doing business, would it not?

The Acting Chairman: Senator Cook feels that if you read it into the record it is easier for study thereafter, rather than having answers on the brief.

Mr. Brooke: The entire paragraph?

Senator Cook: I think the comment.

Mr. Brooke: We say:

> We believe that the structure recommended in the White Paper would be so complex that a large percentage of Canadians would no longer be capable of

preparing tax returns. It would add many complications to the most simple transactions, such as owning a house, and it would impose the tax collectors' judgment on innumerable business transactions. We suggest that the total cost involved in making and assessing tax returns on such items could be out of all proportion to the tax revenue resulting.

Senator Cook: Would you give a few examples of where it would impose the tax collectors' judgment, where the tax collectors' discretion comes into it?

Mr. Brooke: I am sorry, I do not quite follow.

Senator Cook: You say "It would impose the tax collectors' judgment on innumerable business transactions". Would you illustrate some of the transactions?

Mr. Brooke: I think they are in several areas. Capital gains tax is one of them; the valuation of private companies' shares; the valuation of assets in large corporations. In one such as ours we would be faced with enormous problems on valuation day, as to what basis we were going to use with an eventual capital gains tax on disposition.

Senator Cook: That would lead, would it not, to litigation between the tax collector and the taxpayers, which in turn would lead to a great deal of uncertainty?

Mr. Brooke: That is right, and the individual would have just as many problems if they go ahead with the proposal as it now stands on personal small items.

Senator Cook: So it might be ten years before the taxpayers know where they stand?

Mr. Brooke: In my opinion very very many years, 20 years or something like that before it is out of the way.

Mr. Macintyre: Some other examples in this area that come to mind would be the small shareholder getting stock dividends and having to keep track of his cost basis. How does he adjust these things? These are pretty complex concepts for the ordinary man, to say nothing of the complex recording requirements that would be imposed on the corporations who communicate with shareholders. That is just one instance.

Senator Cook: If there is one virtue in income tax it is the virtue of certainty, is it not?

The Acting Chairman: I think honourable senators will be interested in the fact that our Chairman, Senator Hayden, quoted the present Minister of External Affairs, the Honourable Mr. Sharp, on the dangers of introducing a completely revolutionary system —honourable senators will remember that— and we have the references in this brief, on pages C-3 and C-4, to some of the very statements that were made by the Honourable Mr. Sharp when he was Minister of Finance that were referred to by our Chairman. I do not think we need to read them into the record again, but it is of interest to note that it was our Chairman who alerted us to that speech, and the warnings are now reflected in this brief.

Are there any further questions under this heading?

Senator Hays: Among the people you represent are there many wholly owned American subsidiaries?

Mr. Malone: Yes, there would be.

Senator Hays: Mr. Neufeld three or four weeks ago in the Standing Senate Committee on National Finance informed us that American expansion was up 23.4 per cent in 1970 over 1969. In investigating these figures, the amount of money was $2,133 million. Part of this expansion was planned for November before the White Paper was introduced, and part after. Is there any withdrawal of expansion where these companies are wholly-owned subsidiaries among your members? This was a fantastic increase, 23.4 per cent over 1969.

Mr. Malone: The greatest problem of expansion amongst the members of the Association is the ability to introduce projects which will give a proper return. This is paramount over White Paper problems.

Mr. Macdonald: I do not think that I could add anything from personal knowledge on that matter.

Senator Hays: Would it be possible to obtain this information?

Mr. Malone: We do not have information about the particular capital plans of our members. We are endeavouring to devise a system to obtain this. However, I do not think there were many postponements in our industry because of the White Paper.

Senator Hays: In what developed countries is the chemical industry treated better than

your members with respect to taxing now and under the White Paper as you interpret it?

Mr. Macintyre: We have already alluded to the lower tax rate in the United States. Belgium is a good example. They have a 35 per cent corporate tax rate. I understand they impose border taxes, remissible under GATT. Therefore they give that incentive to their industry to penetrate further into world markets.

Recently they embarked on a very conscious plan to attract industry, particularly chemicals. It was a policy decision at the highest Government levels. This was augmented by very generous loan availability, preferential interest rates, subventions, 130 per cent capital cost allowance and write-offs.

Puerto Rico was mentioned in the chemical industry study.

Senator Hays: That is part of the United States.

Mr. Macintyre: As having had over the last three years attracted an estimated three-quarters of a billion dollars of chemical investment, principally by a 10-year tax holiday.

Mr. Brooke: Holland, Belgium and even the United Kingdom give better tax treatment. We do not have a CIL representative here, but ICI are in an area where they receive 40 per cent capital grants in the United Kingdom and a corporate tax rate is allowed.

The Acting Chairman: Honourable senators, I think these witnesses would be competent to deal with a subject that has not been pursued in some of the other briefs in detail, and that is the tax treaty negotiation problems resulting from proposed integration. I have asked these gentlemen to deal with it. I wonder, Senator Benidickson, if you will be good enough to take over while I attend another committee meeting.

(**Senator Benidickson** took the *Chair*)

The Acting Chairman: Mr. Macintyre, would you care to develop your comments on the line that Senator Phillips (Rigaud) suggested to you?

Mr. Macintyre: Thank you, Senator Benidickson. There is a slight reference in our brief to the problems we foresee in Canada's negotiating tax treaties in the event of the adoption of the integration proposals.

I suspect that Mr. Gilmour has perhaps told you this before, but in 1967 France adopted an integration scheme for widely-held companies virtually the same as is proposed for Canadian widely-held companies now. That is, the French shareholder getting $100 worth of dividend takes $150 into income, calculates his tax and claims a $50 tax credit. France, having changed its internal tax system, the international tax treaty with the United States was abrogated and it became necessary for the United States to renegotiate the treaty. The United States insisted that, if France was adopting the principle that the corporate tax represented a prepayment of shareholder tax, then it was discriminatory not to give tax credit refunds to non-resident shareholders. They pursued this matter without too much success for a year or so, but as of January 1, 1970, the United States negotiated a treaty with France whereby the United States portfolio shareholder gets a tax credit refund from the French Treasury. That is, the French shareholder gets a $100 dividend from the corporation and the United States shareholder would get a $100 dividend cheque from the French corporation and he would also get a $50 refund cheque from the French Treasury, minus 15 per cent withholding tax on the whole.

This we suggest has been tasted by the United States. We also suggest that the United States portfolio investment in Canada is much more significant than the United States portfolio investment in France.

The data that we have been able to get our hands on would indicate that approximately 23 per cent of the holdings on listed Canadian stock exchanges are owned by non-resident portfolio investors of the sort who would be entitled to tax credit refunds if Canada were able to assert this principle. We suggest that this, as a minimum, will involve great difficulty for Canada in negotiating a tax treaty with the United States that does not provide for these very substantial tax credit refunds to non-residents.

If the United States were successful in asserting the right to get these tax credit refunds, the fiscal drain would be unthinkable. We suggest this is an area that perhaps has not been thoroughly thought out and that should perhaps receive further attention from you in your discussions with the Department of Finance.

The Acting Chairman: I think you have given us information that is new. We are getting to the point where very little that

does come forward has not been presented before, having had so many briefs presented to date; but that is what Senator Phillips wanted to get on the record, your knowledge of this particular feature.

Senator Burchill: Mr. Chairman, just following the general line, on page 4 of your brief you refer to the competition that you are up against. I think that is very important. You have already indicated that is a bigger problem than the White Paper. You cannot compete. It is not on account of quality you cannot compete, is it?

Mr. Malone: It is because of the economics of our plant size and the normal market we have available to us.

Senator Burchill: In other words, you have not large enough plants?

Mr. Malone: That is correct.

Senator Burchill: Mass production and that sort of thing would reduce your costs?

Mr. Malone: Our plants were large enough by standards of five to ten years ago, but by the present level of new technology our plants are being outmoded.

Senator Burchill: And if you enlarged those plants and increased your production you would be in a position to compete, or largely compete.

Mr. Malone: Provided we had access to reasonable markets. Canada is the only highly industrialized nation which is not part of a trading bloc. The United States is a trading bloc unto itself; it has high tariff barriers opposite Canada in chemicals. The European Economic Community is a large trading bloc, but Canada has only 20 million people widely dispersed without good access to major markets.

Senator Burchill: And the market is not here in Canada?

Mr. Malone: Part of our market is here, but the market is not large enough in Canada to support these large complexes.

Senator Cook: Is there a large element of obsolescence in your plants, apart from depreciation?

Mr. Malone: The main element of obsolescence has been economic obsolescence, the ability to produce at low unit cost. There has been a vast change in chemical technology in the past seven to eight years, where much larger plants are being built with lower unit costs, and this is what is affecting the Canadian chemical industry.

Senator Isnor: Where are they being built?

Mr. Malone: In Europe, Japan and the United States, primarily.

The Acting Chairman: They have been built not entirely because of better tax arrangements, but because they are in a big market.

Mr. Malone: Yes, a bigger market.

Senator Carter: Can you tell us what has been the rate of growth of the chemical industry in recent years?

Mr. Malone: I guess the best thing is to relate it to rate of demand for product, and I would say the demand for product is growing at roughly a 10 per cent per annum, rate. However, it has not been supplied by domestic production but more and more by imported products.

Senator Carter: What has been the rate of growth of your own industry here in Canada? That is what I am trying to get at.

Mr. Malone: I do not have the figure here, but we will get it and supply it to you.

Senator Carter: But it has been growing?

Mr. Malone: Yes.

The Acting Chairman: It has been growing in terms of dollars, but there is in that growth a large element of inflation?

Mr. Malone: That is right. There have not been many price increases in the chemical industry in recent years.

Mr. Macdonald: There has been a price rise of 7 per cent over the last ten years.

Mr. Macintyre: To follow up briefly an observation you made, Mr. Chairman, that tax is not the only factor that is causing plants not to be built here, one can observe that in Europe, given a market available for tapping, the preponderance of the chemical development to date has taken place in those countries where they had a conscious government policy through taxes of attracting the chemical industry.

The Acting Chairman: The bloc gave them the market, and within the market they went

to the countries that gave them a tax advantage.

Senator Burchill: What percentage of your production is exported?

Mr. Malone: I would say roughly between five and ten per cent.

Senator Burchill: Does that go to the continent or to the United States?

Mr. Malone: Both places, but largely to the United States. My own company exports about 25 per cent of its production of chemicals.

The Acting Chairman: Are there any other points that we may have overlooked and that you would like to expound upon?

Mr. Malone: No, Mr. Chairman, I think our main points have been fully covered. Many of our points were on the broad economic aspect, and I think we have had a pretty good discussion of them. I do not think we have anything further that we wish to raise.

The Acting Chairman: Then, Mr. Malone, we thank you and your colleagues for the information you have made available to us, and particularly that in addition to what is contained in your brief.

The committee adjourned.

APPENDIX "A"

THE OUTCOME OF INCOME

A Statement by The Canadian Manufacturers' Association to the members of the Senate Standing Committee on Banking, Trade and Commerce and the members of the House of Commons Standing Committee on Finance, Trade and Economic Affairs on the Government's proposals for tax reform.

April, 1970

THE CANADIAN MANUFACTURERS' ASSOCIATION
67 Yonge Street, Toronto

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Introduction and Summary

The Canadian Manufacturers' Association was established 99 years ago with the object and aim of promoting manufacturing in Canada. It is a non-profit, non-political organization of approximately 7,700 members in every branch of manufacturing industry from coast to coast. It is estimated that the total production of its members amounts to about 75 per cent of Canada's total manufacturing.

2. The question of taxes and their impact on manufacturing activity has been traditionally of major concern to the Association. It was for this reason that the CMA welcomed the appointment of the Royal Commission on Taxation in 1962 and subsequently undertook a comprehensive examination of Canada's tax system from industry's point of view. In response to the Commission's invitation, the CMA submitted two written briefs and supplemented these with oral presentations. Following the publication of the Royal Commission's report, the Association re-examined its views in the light of the Commission's findings and recommendations. The results of this internal study culminated in the CMA's assessment of the report and a lengthy submission expressing the Association's position was presented to the Minister of Finance in September 1967.

3. This Statement on the White Paper proposals was prepared under the direction of the Association's Taxation Committee which formed eight Study Groups to consider each of the chapters of the White Paper. In correlating the views of its members the Association drew on the knowledge and experience of those who serve on the Executive and Taxation Committees of its six geographical Divisions, as well as its national Executive Committee and Executive Council.

4. The CMA recognizes the White Paper as the Government's contribution to the ongoing public debate about tax reform. By issuing a document for discussion and review rather than a Bill for legislative action the Government has made a commendable decision which the Association warmly applauds. The tentative and flexible nature of the proposals, however, in no way lessens the impact of the White Paper as a clear reflection of taxation principles espoused by the Government. Therefore, the underlying principles just as much as the specific proposals warrant close attention and the Association's submission is designed to assist in the appraisal of both.

5. The Association's position with respect to the major proposals in the White Paper is summarized below.

ECONOMIC IMPACT

6. The Association disagrees with the priorities implicit in the White Paper's statement: "The second main objective of tax reform is to see that the tax system does not interfere seriously with economic growth and productivity" (1.10). We consider that priority should be given to the objective of economic growth which goes hand in hand with improving the quality of life. We believe that the benefits of improved equity should follow and complement rather than appear as alternative to gains resulting from a steady and balanced expansion of output.

7. We consider that the White Paper must be criticized on four fundamental grounds:

(a) It proposes an overall level of taxation and government expenditure which are incompatible with our present stage of development and our need to remain internationally competitive;

(b) It proposes shifts in the incidence of taxation — individual and corporate — that will penalize initiative and repress capital investment;

(c) It is incomplete in that it proposes nothing about other forms of taxes, such as commodity taxes and estate duties;

(d) It is inconsiderate of the needs of junior governments for tax revenues and could lead to a tax jungle in which any move toward the federal objectives of equity and neutrality is completely thwarted.

INDIVIDUAL AND FAMILY IN TAX REFORM

8. The Association commends the Government's motive in giving relief to low income earners and commends the proposals which would permit the deductibility of child care expenses and of costs to employees of earning their living. However, we are gravely concerned about the proposed increases in the tax rate of middle income earners, i.e. taxpayers earning between $9,100 and $24,000 per annum. The Association recommends that every effort should be made to reduce the impact on these taxpayers.

9. We consider that the proposed averaging formula would give very little relief and recommend that existing averaging formulae should be retained in those circumstances where they now apply and that a more effective general averaging provision should be made available for all taxpayers.

CAPITAL GAINS

10. The Association is not convinced that a capital gains tax is desirable at this time in Canada. However, when Canada reaches a stage of economic development where capital requirements of a full employment economy can be provided at reasonable rates from private savings, it may be appropriate to tax capital gains. Such a tax should be imposed gradually and should be at a much lower rate than that proposed in the White Paper and should be contained in a separate rate schedule.

CORPORATIONS AND THEIR SHAREHOLDERS

11. Insofar as small businesses are concerned, the Association disagrees with the White Paper's proposal to eliminate the low corporate tax rate on the first $35,000 of all corporate taxable income. Smaller companies experience difficulties in accumulating capital for future growth and we suggest the retention of the incentive provided by the low corporate tax rate for companies with incomes under $250,000.

12. We disagree with the White Paper's proposal to integrate personal and corporate income and recommend that the existing dividend tax credit should be retained and increased from 20 per cent to 25 per cent.

BUSINESS AND PROPERTY INCOME

13. The Association welcomes the White Paper's proposal to set up a new class of depreciable assets called "nothings."

14. We disagree with the proposal that enterainment and related expenses should no longer be deductible.

15. We are also concerned to note that the authors of the White Paper intend to deal separately with the capital cost allowance system. We consider that the Government's intentions in relation to the capital cost allowance system and in relation to sales taxes should be made known as soon as possible so that they can be considered jointly with the White Paper proposals.

RESOURCE INDUSTRIES

16. The Association considers that the proposal to phase out the three-year exemption for new mines and for depletion allowance to be "earned" would reduce the growth of the extractive industries with a resultant slow down in the growth of secondary industries and in our export income. The Association considers that the existing incentives should be continued.

INTERNATIONAL INCOME

17. The capital gains and withholding tax proposals would reduce the attractiveness of investment by non-residents in Canada.

18. The "passive income" proposals would be a threat to selling efforts vital to Canadian exports and the proposed distinction in the treatment of income from controlled foreign corporations depending on whether the corporation is in a treaty or non-treaty country, is not justified.

CO-ORDINATION WITH THE PROVINCES

19. The Association welcomes the proposal that the federal government will continue to collect provincial income taxes and hopes that agreement can be reached with the provinces for the implementation of this proposal.

20. We note that the White Paper projections assume that the provinces will be satisfied with 28 per cent of the federal personal income tax (higher in Quebec) and 10 – 13 per cent corporate income tax. Until the provinces indicate that they are satisfied with these assumptions, we consider that it is difficult to assess the White Paper and urge that agreement should be reached with the provinces on these matters as soon as possible.

Proposals for Tax Reform - An Overview

REFORM OR AMENDMENT?

21. It has become common to describe the existing tax system in terms which imply the urgency and inevitability of a complete overhaul. Indeed, the White Paper observes that "the need for a general reform is clear, and in some instances striking" (1.3). However, it should be recalled that according to the Royal Commission's Report, "the present Canadian tax system is as good as most other systems" (Vol. 1, page 2) and the justification for far-reaching reforms is not as much the pressure of actual short-comings and wrong-doings as the desire to create for Canada "the best possible tax system " (Vol. 1, page 3). Most tax practitioners and students of the Canadian system would agree that in some instances, such as in the case of apparent evasions and loopholes, there is room for change. But this is a matter of adjustment rather than general reform. It can be achieved through specific regulatory and court actions. Indeed, insofar as "evasions" and "loopholes" in the existing system are advanced as a justification for the sweeping reform proposals in the White Paper, it appears ironic to the Association thatour present system is to be discarded at a time when most of the identifiable evasions and loopholes are no longer permitted.

22. It is well known that for all practical purposes evasion of tax made possible by surplus stripping and spreading corporate income through a series of companies to get the lower rate is no longer possible because of the provisions of Section 138 A of the Income Tax Act. These amendments were introduced in 1963. In the area of international income, changes in the Income Tax Act have eliminated the most blatant avoidance devices. Fairly minor changes in legislation, it is submitted, could prevent any remaining abuses.

23. The desirability of sweeping tax reform is all too often taken for granted in public discussions. A reform which aims to achieve "the best possible" is an inherently attractive proposal, even though the implementation of such a scheme is hardly practicable. Even more basic questions can be raised in connection with a partial reform package, such as the White Paper proposals, which proceeds from the assumption that the present system is inadequate and unjust because it has evolved in a piecemeal fashion over the decades. While evidence for the inadequacy of certain features of the tax system and for the unequal distribution of certain tax burdens can be found, as the Association itself has pointed out in earlier submissions, there is reason to be sceptical that an attempt which concentrates exclusively on income taxes would succeed in eliminating them.

24. For reasons to be explained in this submission, the Association has concluded that the White Paper constitutes an unwise fiscal experiment. The desirable objectives and some of the proposals of the document may be implemented outside the framework of an ostensible tax reform.

THE AIMS OF TAX REFORM

25. The White Paper proposes major changes in the Canadian income tax system for purposes of achieving greater equity and neutrality. Equity is described as "fairness" in the horizontal and vertical distribution of a tax burden while neutrality is referred to, we assume, in paragraphs 1.10 and 1.11 of the White Paper. The concepts of equity and neutrality have occupied a dominant position in the list of priorities drawn up by the Royal Commission and thus some of the Association's earlier observations apply to the White Paper as well.

26. The White Paper enumerates a number of goals and standards and it goes almost without saying that manufacturers subscribe to such a list. The Associa-

tion differs however, from the authors of the White Paper with respect to the relative importance and urgency attached to the several goals. The Association believes that top priority should be given to the objective of economic growth which goes hand in hand with improving the quality of life. Of course, policies which provide the greatest stimulus to growth may be in conflict with those which aim at the maximum degree of equity. At the same time, the Association believes that both ends are desirable and that a workable compromise must be found between them, and that the benefits of improved equity should follow and complement, rather than appear as alternative to, gains resulting from a steady and balanced expansion of output.

27. A rising standard of living is primarily a function of the rate of economic growth. This may be illustrated by comparing the impact of the proposed tax changes on the one hand and the implications of a steady rate of economic growth on the other hand. Taking the effect of new exemptions, new rate schedule and new deduction from employment income as proposed by the White Paper, the amount of reduction for a married taxpayer with two dependent children would range from $15 (with an income of $2,800) to $127 (with an income of $4,000). These reductions represent 0.5 per cent and 3.2 per cent of the taxpayer's income respectively and would, we submit, yield a very small improvement in their standard of living. On the other hand, the maintenance of a 5 1/2 per cent real growth rate in the GNP (and allowing for growth in population), would mean a doubling of per capita income in somewhat over two decades. Obviously then, a prime goal of national economic policy should be the promotion of growth.

28. The White Paper's approach to neutrality is of concern to the Association because it reveals an unrealistic attitude toward the role and impact of taxation in the economic system. In fact, modern taxes may be said to play a twofold function:

(a) they produce revenues to finance the activities of the public sector, and

(b) they influence and direct all facets of economic activity by individuals and private organizations.

Since the tax system is a prime policy intrument of the government and it is used with particular policy objectives in mind, the concept of a "neutral tax system" is a contradiction in terms when brought outside the theoretical framework. It will be recalled that the Royal Commission envisaged neutrality only in relation to a total tax system. The Report explicitly recognized that taxes are a policy instrument and contained the proviso that any alteration of the delicately balanced tax package would destroy the overall neutrality of the system. We consider that the White Paper, which deals with only selected components, cannot offer even theoretical neutrality.

29. In particular, the White Paper ignores sales taxes and it merely serves notice that there will be a subsequent review of capital cost allowances. The ommission of these two important features from an outline of a reformed tax system makes it very difficult, if not impossible, to ancitipate the full impact of the White Paper proposals. We believe that changes in the tax system of the magnitude proposed in the White Paper should not be dealt with in isolation. Yet, last year's changes to estate and gift taxes and the introduction of taxes on life insurance investment income and profits appear to indicate that this is precisely the Government's intention.

30. Tax experts generally accept that taxes in the real world are never neutral. On the contrary, they do — as they should — influence economic growth by their direct and indirect effects. It is on this premise that the Association has analyzed the implications of the White Paper and has concluded that the net effect of the major proposals would be detrimental to the Canadian economy.

ECONOMIC EFFECTS

31. In simplest terms, economic growth is a function of productivity and the size of the employed labour force. The size of the Canadian labour force is expected to rise rapidly throughout much of this decade and the creation of job opportunities will remain a challenge for economic policy. In addition, substantial productivity gains are required to maintain Canada's international competitive position. The need is obvious for an overall economic policy which is directed toward the encouragement of substantial capital outlays in the productive sectors of the economy.

32. According to the White Paper, the proposals would have only a "relatively modest impact upon the Canadian economy" (8.35). The Association cannot accept this assertion, particularly in view of the shifts in the incidence of taxation and the reductions in the rate of saving and investment which

would follow the implementation of the proposed tax measures. Both types of change would have a significantly negative effect on the rate of economic growth.

33. Even if the White Paper proposals would produce only a "modest reduction" in personal and corporate savings (8.49) the Association believes that this still would be undesirable. We urge that any changes in the tax system should not even modestly reduce saving in the private sector but rather should provide incentives for the accelerated build-up of capital.

34. The economic growth of Canada depends on continuing large-scale formation of capital, which must, of necessity, contain a large portion of foreign investment. The Association considers that the White Paper discriminates against foreign capital. To the extent that foreign investment is deterred, Canada will have to generate additional domestic savings to finance the foregone capital. Yet, we find that the White Paper proposals have a disincentive effect on the rate of domestic savings. All of this suggests that the White Paper would, in the long run, inhibit the formation of capital and, in turn, reduce Canada's potential for economic growth.

35. The decline in private savings, hence investment capital, is matched by rising public revenues, as the White Paper notes. The document, however, fails to point out the fundamental distinction between the economic consequences of increases in productive capital and government revenues. Higher revenues may be used to increase the country's social capital, which does not usually yield economic returns in the short run. To be sure, social capital is needed and the CMA has no doubts about the benefits such investments could produce. But the aggregate of national saving is a relatively scarce resource. The reallocation of capital from the private to the public sector as implied by the White Paper proposals, would reduce the economy's income generating capacity. Against this background the 3.9 per cent decrease in savings estimated in the White Paper is highly significant.

36. But perhaps what gives the Association most concern is the philosopy underlying the White Paper proposals. The Association rejects any philosophy which considers it inherently desirable to take more savings out of private hands and entrust them to the government. We believe the greater the reliance on the government as a saver and spender, the lesser the likelihood of significant efficiency gains in the allocation of the nation's resources. By increasing government revenues, the proposed tax changes show a bias towards the public sector at the expense of the private sector. The magnitude of the increase is subject to controversy; according to the White Paper it would be $630 million or 5.7 per cent but alternative estimates by the Government of Ontario suggest a figure more than twice as high. If two competent research organizations using similar raw data can come up with two drastically different sets of results, there is a reason to doubt the confident assertion of the White Paper: ". . . that the forecast of total revenue . . . is subject to only a modest error — at most five per cent — and is not biased in one direction or the other" (8.6).

37. Turning now to the question of the redistributive effects of the proposals, the White Paper argues that the measures would significantly improve equity by reducing or removing taxes on lower income taxpayers and increasing the tax burden on persons in high income brackets. In fact, however, the White Paper does not demonstrate that the proposals would have this effect. The statistical tables provide no information regarding the incidence of taxation under the proposed system. They only illustrate "before and after" effects by income categories and do not show changes in the distribution of the actual tax load. Furthermore, the White Paper proposes changes in the definition of income. These changes would tend to push taxpayers into higher brackets than at present. Thus, a taxpayer in the so-called middle income range would find himself in a higher taxable income bracket as well as being confronted by higher tax rates. The double-barrelled nature of the increase can be easily overlooked if one focuses on the White Paper's overly simple "before and after" presentation.

38. The major item which would change taxable income along the lines noted above is the proposed capital gains tax. The White Paper argues that this tax would fall on people with very high incomes (1.22); the possible impact of the gains tax on middle income taxpayers is completely ignored. The CMA is of the view that it is misleading to imply that a capital gains tax is a "soak the rich" proposal. According to available evidence, as described below, the tax would have significant impact on a wide spectrum of the taxpaying population. Though the White Paper utilized data from the United States of America for its initial assessment of the economic effect of the capital gains tax, the CMA believes that Canadian statistics assembled for the Royal Commission on Banking and Finance may help in appraising the distributive effects of such a tax.

39. In a survey of consumer finances, researches for the Royal Commission on Banking and Finance found substantial holdings in cash producing equity among middle income taxpayers. (Royal Commission on Banking and Finance, Appendix Vol. 1964, especially Tables 3 and 15). The 1962 survey found that urban households with income in the $5,000 to $15,000 range held between 14.8 per cent and 32.6 per cent of their total assets in the form of publicly traded shares, shares in investment mutuals, trusts or clubs, equity in own business and rental real estate. To illustrate the actual amounts involved, it should be noted that the average household in the $5,000 to $6,000 income bracket was found to have total assets of $12,185 including the family dwelling. Taking 14.8 per cent of this sum, the equity holdings come to $1,803 – the bulk of it to be subject to capital gains taxation under the White Paper proposals. Of course the corresponding amounts for higher income households would be substantially greater.

40. The White Paper devotes but a few pages to the discussion of the economic effects of the proposed tax changes. The issues dealt with in the document are narrowly conceived and receive cursory treatment. No reference is made to the possible consequences of the reform measures on such matters as productivity and industrial expansion, international competitiveness, employment trends and regional development, to mention only the more obvious omissions.

41. Regarding the effect of taxes on the incentive to work and save, there appears to be general agreement that high marginal tax rates tend to put a premium on leisure over work and on consumption over saving. The White Paper accepts this view with respect to marginal rates over 50 per cent. We believe it inconsistent, then, to argue that in the case of taxpayers with incomes up to $15,000 or $17,000 "the (marginal) tax rate increases do not seem large enough to change behaviour patterns in any marked degree" (8.37). The Association submits that the proportional increase in marginal rates must be considered a significant factor when assessing the probable effect of such increases. The increase in marginal rates of tax in the case of taxable income of $10,000 would be 19 per cent. This, of course, is omitting the effect of the new definition of income as proposed in the White Paper which, as noted earlier, would tend to put the taxpayer's taxable income into a higher bracket.

42. The Association believes that a comparison of Canadian and United States tax rates, after changes in both countries, would provide an inducement for some Canadians to migrate to the United States. The White Paper observes "changes in conditions in the U.S. seem to have made that country less attractive to Canadians considering immigration and changes in its immigration laws have made it more difficult for Canadians to immigrate to the U.S." (8.38). Even if these restrictions on international mobility are accepted at face value they have little significance, we submit, for individuals with highly marketable skills in professions and business – Canadians whose contributions this country cannot afford to lose. Even more significant, the same comparisons will reduce the attraction of this country for prospective immigrants having the productive potential we seek.

43. Regarding the balance of payments effects, the White Paper predicts that the inflows and outflows will roughly offset each other and the net result will be a modest improvement. In the absence of any supporting data for this conclusion, the Association finds it difficult to share the Government's optimism. Given a set of tax changes which result in a shift of funds from savings to consumption, the traditionally high import component of Canadian consumer expenditures is likely to be reflected in a deterioration of the current account balance. In the longer run the current balance may be further affected if the White Paper proposals create – as the Association believes – a substantial shortage of investment capital for the expansion of domestic output.

44. The narrow interpretation of the impact of the proposed changes is further evidenced by the fact that the White Paper overlooks the requirements of regional development in its treatment of small business. Small firms play an important part in providing employment opportunities, especially in the slower growing regions of the country. We believe that revenue gains from removal of the lower rate of taxes would be more than offset by the direct government assistance probably required to help people displaced because of the impact of higher taxes on small businesses.

45. The Association is convinced that the implementation of the White Paper proposals would depress the potential rate of growth in production and employment. The negative consequences would not be accompanied by significant improvements in the overall equity of the tax system. Any improvement in the position of low income Canadians would be subject to erosion as the unfavourable side effects

of the proposed tax changes worked their way through the system.

46. The Association is of the view that the White Paper is open to criticism on four fundamental grounds:

(a) It proposes an overall level of taxation and government expenditure which are incompatible with our present stage of development and our need to remain internationally competitive;

(b) It proposes shifts in the incidence of taxation — individual and corporate — that will penalize initiative and repress capital investment;

(c) It is incomplete in that it proposes nothing about other forms of taxes, such as commodity taxes and estate duties;

(d) It is inconsiderate of the needs of junior governments for tax revenues and could lead to a tax jungle in which any move toward the federal objectives of equity and neutrality is completely thwarted.

The Individual and Family in Tax Reform

47. The Association commends the Government's proposal of tax relief for people at the lower end of the income scale but believes this should be done without further tax increases at other income levels. The proposals which would permit the deductibility of child care expenses and of costs to employees of earning their living are particularly commendable. We are concerned, however, about the proposals which would substantially increase the tax burden on Canadians earning more than $9,000 per year.

48. The White Paper's projections understate the effect of the proposals on this group of taxpayers in three ways. First, the proposed new definition of "income.' would increase the tax load on these Canadians. Second, the projections are based on estimated 1969 tax returns and the income would not include any capital gains. Third, the proposals, if implemented, would not come into effect until 1971 at the earliest, and the revenue projections do not take into account the effects of inflation.

49. The Association submits that middle income Canadians should receive the benefits of any adjustments in the White Paper's estimates of revenues which these factors will require.

50. The increasing disparity between the United States and Canadian tax rates offers cogent reason for such action not only because the U.S. rates are the best available measure of the reasonableness of those in Canada, but also because the extent of the disparity may well be decisive in the minds of able, highly-trained, mobile personnel seeking to exercise their talents in a more hospitable economic climate. The White Paper acknowledges the importance of retaining Canadians with outstanding ability but of equal importance is that we continue to attract immigrants of the kind that can make a contribution to Canadian economic and cultural progress. The proposed tax increases on taxpayers earning more than $9,000 is a move in the wrong direction for they neither encourage desirable immigrants nor the retention of Canadians which the country cannot afford to lose.

51. It is clear that the White Paper proposals will have the effect of increasing taxes for most Canadians and that the resultant additional revenue is more than enough to offset the increased personal exemptions. This assumes — quite wrongly we sincerely hope — that governments will continue to absorb an ever-higher proportion of Canada's national income.

52. So much for the rates of tax and the scale of progression described in the White Paper. The Association wishes to note in addition a number of observations and recommendations concerning specific aspects of the tax proposals relating to the individual and the family.

53. The proposed averaging formula would give very little relief to taxpayers with highly variable income and we consider that a more effective general averaging provision should be made available for all taxpayers. We consider there are still good reasons for special averaging provisions for lump sum payments out of pension and deferred profit-sharing plans, for death benefits and payments on loss of office and for stock option benefits, and we recommend that the existing averaging formulae be retained for these payments.

54. We commend the proposal to permit the deductibility of employees' moving expenses and we suggest that a carry-over should be permitted for moving expenses incurred late in the year.

55. We commend the proposal to permit the deductibility of unemployment insurance premiums.

56. The proposed continuation of the allowance for medical expenses is for all practical purposes eliminated by the intention to disallow the major items of such expenses. If public health plan costs are to be excluded, we recommend that all other medical

expenses be deductible and not just those amounts in excess of 3 per cent of income.

57. In relation to the proposals with respect to pension and retirement savings plans we make the following recommendations and observations:

(i) We recommend continuation of the present provision whereby there is no tax on pension income arising out of contributions which were not allowed as a deduction when they were paid.

(ii) We recommend that the proposed right of a widow to offset or reduce income by contributing all or part of the proceeds of savings withdrawn to a registered retirement savings plan of her own should be extended to other beneficiaries. It should also apply to payments of the kind to which this type of provision applies now, i.e. lump sum payments from pension plans and deferred profit-sharing plans, and retiring allowances.

(iii) Rules that might be drawn to ensure that trustees are responsible for paying taxes arising out of the operation of a pension fund should impose no greater responsibility than withholding tax requirements for trustees of funds.

(iv) We consider it desirable to encourage investment in Canadian securities but we do not agree with the proposal that no more than 10 per cent of the assets of a pension fund may be in foreign securities or investments.

(v) We suggest that a withholding tax be applied to pension payments to non-residents only if they can obtain credit for it against income tax in their country of residence.

Capital Gains as Income

58. The Association has already stated that the primary aim of tax policy should be the promotion of economic growth. Maximum economic growth will not be achieved unless a high rate of private savings in Canada and substantial foreign investment continue. The Association believes, for reasons outlined more fully below, that the economy's full growth potential will not be realized if a capital gains tax as proposed is introduced, and we therefore oppose the imposition of such a tax at this time.

59. The prospect for continued substantial foreign investment in Canada to the extent required is not reassuring. The Economic Council has noted that very heavy world demand will make it difficult for Canada to continue to attract large amounts of foreign capital. Reduced economic incentives in Canada, which would be brought about by proposed increased taxation, must reduce attraction of foreign capital. The taxation of capital gains realized (or deemed realized in some cases) by foreigners on Canadian investments would undoubtedly inhibit foreign investment in this country.

60. The Association also believes that the taxation of capital gains, accompanied by probable increased dividend payments by corporations to preserve tax credits to shareholders and the proposed increase in tax rates, would reduce private savings substantially. We expect many taxpayers, if not the majority, after paying higher taxes, would tend to dispose of their remaining income on consumer goods and services because incentives to save would be reduced. We doubt that the reduction in private savings will be as modest as the White Paper estimates.

61. The Association also doubts the White Paper's contention that reduced private savings and a fall-off of foreign investment would be offset by a reduction in the outflow of Canadian savings for foreign investment. The White Paper's conclusion was based on the assumption that penalties on such investments in the form of full capital gains taxes, an absence of creditable tax applicable to dividends and restrictions on pension funds would encourage increased investments in Canadian equities and bonds. However, we believe that these disadvantages may be more than offset in many investors' minds by the following factors:

(i) Foreign equities would not be subject to the capital gains tax every five years. This would enable the investor to liquidate his holdings at a time of his choosing rather than face the possibility of a forced sale to pay his tax liability if he invested in Canadian equities.

(ii) The investor who is inclined toward growth-potential or resource-based equities could find that Canadian stocks would not be attractive because of the absence of, or lower creditable tax applicable to dividends, thereby removing the "partial integration" advantage applicable to Canadian equities.

(iii) Reduced economic returns of Canadian enterprises, especially due to increased tax burdens or for other economic reasons, may make investment in foreign equities and bonds relatively more attractive in spite of some possible tax disadvantages. The Association submits that the tax

62. The Association submits that the tax as proposed would have the following additional undesirable effects:

(i) Corporations could be pressured into increasing dividend payouts, to prevent tax credits from becoming stale-dated and to reduce capital gains, frequently contrary to good business practice. The alternative of issuing stock dividends to preserve funds would be cumbersome and could have unfortunate tax consequences for foreign investors.

(ii) The deemed realization of gains upon a taxpayer's departure from Canada would discourage persons from leaving or entering the country for short periods of residence. This temporary exchange movement of skilled persons is essential to Canada's industrialized economy.

(iii) The quinquennial valuation of the shares of widely-held corporations and payment of the applicable tax on deemed realizations of gains could lead to forced sales of stock at inappropriate times and could, in an extreme case, result in loss of control of such corporations. Also, the valuation of shares at the price of shares traded on a particular day could produce unrealistic and devastating results. Market prices frequently do not represent true value of shares, particularly of a controlling interest in a company. They often reflect only speculative prospects in the minds of investors with little or no basis in fact. A drop in the market value of shares from the valuation date to the date the tax is payable might even force a person to sell his entire interest in a company in order to pay the capital gains tax. Although the loss suffered on the disposal would be deductible in the subsequent taxation year this would be of little comfort to the person who has lost control of his company.

(iv) The quinquennial valuation and tax payment requirement would likely discourage some private companies from becoming public companies.Such companies' best hope for further growth would then be through private participation or merger, which, because of the relative availability of foreign capital, will inevitably increase foreign ownership of Canadian enterprises. Insofar as existing closely-held companies are foreign owned, the lock-in effect would discourage them from going public. Yet, we understand it is government policy to encourage such companies to offer their shares to Canadians.

(v) In many cases increases in the dollar value of property represent only inflationary gains. The White Paper does not propose to exempt inflationary gains from tax. This is unjust because a tax on inflationary gains is really a confiscation of capital and not a tax on income.

(vi) Taxation of capital gains at full marginal rates with only limited averaging provisions would, in many cases, be more severe than a similar tax imposed by any country with which we are economically associated. The sudden imposition of such a tax at the proposed rates in a country which to date has been accustomed to tax-free capital gains could well have serious unsettling effects on the economy through a change in taxpayers' attitudes and habits, particularly those taxpayers earning $10,000 per annum and more whose skills, savings, investment, ambition and drive are essential to an expanding economy. The change in attitude could result in increased spending on consumption rather than saving and a reduction of capital investment. The total effect would be to discourage the initiative of some of Canada's most dynamic and productive people.

These comments are particularly relevant in the light of recent heavy increases in estate and gift taxes which, along with the proposed capital gains tax constitute taxes on saving. As all three taxes may be avoided by spending rather than saving, one must conclude that their imposition encourages the former at the expense of the latter and causes erosion of capital formations which are necessary for a growing economy.

(vii) The practical problems associated with valuing taxpayers' assets on Valuation Day in a manner that will be acceptable to both the taxpayer and tax collector several years hence are substantial. Because values of most types of property cannot be determined with any degree of precision until a willing buyer is found and a sale is consummated, most valuations must be arbitrary.

(viii) The proposal to tax foreign shareholders on quinquennial gains of Canadian widely-held corporations and realizations from certain sales is not provided for under present international agreements, and it is unlikely that the proposal would be agreed to in the future. Certainly, there would be difficulties in enforcing such a tax law.

(ix) The taxation of capital gains realized on the sale of residences could have the unfortunate consequence of inhibiting certain taxpayers from selling their residences even at times when it is appropriate for them to do so. For these people, where accumulated gains have been reinvested over a period of years through the roll-over provisions, the potential capital gains tax would be socially undesirable in that it would penalize, for example, the person who is retiring and desires to move to a more favourable climate. In many such cases the proceeds realized from the

sale of the residences represent the major portion of the individuals' lifelong savings for their retirement years.

(x) The use of stock ownership plans, particularly by smaller companies with growth potential, has been a valuable aid in securing highly skilled technical and managerial personnel necessary for the success of an enterprise. The prospect of realizing a tax-free capital gain provided the incentive to put forth maximum effort to make the enterprise grow and prosper. The taxation of such gains would largely remove this incentive, thereby making it more difficult to encourage qualified personnel to abandon secure positions to assume the more risky tasks of building a new venture. Similarly, the present favourable tax treatment for benefits under stock option plans has been an important incentive for management, and we consider this favourable tax treatment should be continued.

63. The Association believes that a capital gains tax is not appropriate in Canada at this stage of its economic growth. We note that a capital gains tax was only introduced in U.S.A. and the United Kingdom after their economies were well developed, and these tax systems still provided ample opportunities for the formation of private capital. Australia, with an economy comparable to that of Canada, does not have a capital gains tax.

64. When Canada reaches a stage of economic development where capital requirements of a full employment economy can be provided at reasonable rates from private savings, it may be appropriate to introduce a tax on capital gains. Such a tax should be imposed gradually and should be much less severe than that proposed by the White Paper. If at some future date it is appropriate to introduce such a tax, the Association recommends that the following specific amendments to the White Paper proposals be made:

(i) The rate should be substantially lower and should be set out in a separate rate schedule. Ventures in the nature of trade should continue to be taxed as ordinary income as they are under the present system.

(ii) A more equitable system of averaging should be devised.

(iii) The gains should be adjusted by an index, similar to the consumer price index, to determine the true gain in terms of constant dollars.

(iv) Gains arising from the sale of personal objects and hobby items should be exempt because enforcement of a gains tax on such items would be impossible and because these items seldom represent investment goods.

(v) The roll-over privilege should be extended to business property acquired to replace existing property. This would remove penalties that might otherwise apply to growing businesses which find it necessary to move to new locations for expansion purposes.

(vi) The tax should not apply to a taxpayer's principal residence because it would inhibit taxpayers adjusting their accommodation to suit their needs and would raise a further obstacle to home ownership. Moreover, a person's residence is in the nature of a consumption item rather than an investment item. The White Paper recognizes this in refusing to allow losses or carrying charges on residences to be deducted from other income. Consistency should entail the exemption of gains on a taxpayer's principal residence from a capital gains tax.

(vii) The quinquennial valuation and taxation proposal should be abandoned. Tax should apply only to gains realized on the sale of shares in widely held Canadian companies. The Association's reasoning on this point is previously stated.

(viii) To avoid the taxation of gains after valuation day which in reality are only the recovery of losses accrued between the date of acquisition and the date of valuation, taxpayers should be permitted to deduct from proceeds of sales the greater of either the original cost or valuation day value.

(ix) To avoid a double penalty of taxes on capital in the form of death, gift and capital gains taxes, rates of estate and gift taxes should be greatly reduced. In the Ontario Government's 1969 budget paper on proposed tax reform, it is stated that the need for the taxation of estates should diminish as the capital gains tax becomes effective and, therefore, estate taxation should gradually be eliminated.

Corporations and Their Shareholders

65. Although the Association does not wish to enter at this time the debate as to whether it is the shareholder, the employee, the corporation itself or the customer who bears the impact of corporation tax, we make the following observations. First, we tend to agree with the recent comments of Prof. W.G. Leonard of Queen's University, that the tax system should be designed with a "..... scientific adjustment of burdens to enterprise capabilities unhampered by irrelevant theorizing concerning integration of tax loads on business profits with tax loads on incomes of individuals. ..... No logical relationship exists between tax rates on business profits and amounts received or receivable by individuals for personal or family spending."

66. Second, we believe that much of the past discussion about "double taxation" has really been an expression of concern about the level of tax on the private business sector. It has been motivated by a belief that Canada's international goals and the economic well-being of all its citizens will be best achieved by lowering the tax burden on business activity to encourage economic growth and investment in the private sector and to improve our international competitive position, and by providing increased incentives to Canadians to invest their savings and their individual efforts in Canadian enterprises.

67. The corporation rate shown in all of the examples in the White Paper is 50 per cent. We consider this to be unrealistic, having regard to provincial revenue pressures. With provincial taxes, it must be assumed the rate will more likely be in the order of 53 per cent if the federal government retains its indicated share. Moreover, considering other countries where like rates are lower (U.K. — 45 per cent), or indicated to be trending lower (U.S. federal/state — approximately 50 per cent by 1971), it is desirable that the corporation tax rate in Canada be even lower than 50 per cent. This would improve Canada's international competitive position and encourage economic growth. In this connection, it may be noted that a U.S. parent corporation considering transferring export business from U.S. plants to Canada would be comparing U.S. rates with a Canadian rate of approximately 60 per cent — a 52-53 per cent Canadian tax plus a withholding tax of 7 1/2 per cent.

68. A lower corporate rate would stimulate growth and, we believe, generate even larger tax revenue in the long run. The Association believes that it is relevant at this point to emphasize the need for an early reform of our tax system which would place greater reliance on indirect sales taxes, with a complementary reduction of corporate profit taxes. The lower corporate rate in other countries, the demonstrated success in Europe of the combination of large corporate tax write-off incentives and an emphasis on commodity taxes as a powerful tool to increase exports, the serious consideration in the U.S. to a shift from corporate to indirect tax — all suggest that Canadian reform in this direction is urgently needed.

69. The proposal in the White Paper to eliminate the low corporate tax rate has caused the Association great concern. We believe that this proposal would seriously curtail the growth of many small Canadian manufacturers, and inhibit the establishment of others. The integration and other proposals would only increase the existing difficulty which small companies have in attracting and accumulating capital for growth. It is probable that some companies now operating at the economic margin will, if the proposals are implemented, have to close their doors and many people will, as a result, find themselves jobless. Severe secondary effects will therefore be felt throughout the remainder of the Canadian economy.

70. Although it is possible that other incentives, such as fast capital cost allowance, a 150 per cent capital cost allowance or a special working capital allowance, could offset the loss of the low rate incentive for small, expanding companies, such assistance would do nothing to alleviate the plight of many companies which do not have a large capital investment or which are unable to expand but do provide employment in their community.

71. We therefore recommend that the present low rate of tax on the first $35,000 of corporate income be retained. We recommend against adoption of integration but, if integration is to be implemented, we urge the government to try to find some way to adjust the flow-through mechanics of creditable tax to accommodate the low rate.

72. We have already expressed the view that the overall corporate tax burden should be decreased, rather than increased, in order to improve Canada's international competitiveness. We also note that removal of the low rate on the first $35,000 of corporate income represents an increase in the taxation of all corporations. Notwithstanding these factors, we believe that most manufacturers would not object to the removal of the low rate when the smaller company has grown to an income level where an increase in the tax rate from 21 per cent to 50 per cent would not have too great a relative impact on available funds for growth. Accordingly, we believe most "larger" companies would, in the interest of preserving growth opportunities for smaller companies, not object to the removal of the low rate on the first $35,000 when taxable income reaches, say, $250,000. At this income level, the payment of the extra $10,000 of tax represents an increase of just under 10 per cent in the tax bill. If the White Paper proposals are implemented, the tax bill for a company earning $35,000 would, after transition, be increased by 140 per cent - 150 per cent.

73. To avoid hardships where incomes fluctuate, we further suggest that the low rate be removed only if the average taxable income of, say, the three preceding years, exceeds $250,000. Where associated companies are involved, the low rate should disappear when the taxable incomes of the group aggregate to an average of $250,000. In this connection, we do not believe the current allegation that large corporations are able to carve themselves up into many small companies and obtain multiple advantage of the present low corporate rate. Legislation in effect since 1963, and backed by court decisions in favour of the Crown, has effectively prevented such abuses.

74. The White Paper anticipates that its integration proposals would "provide a powerful incentive for investment by Canadians in Canadian corporations." Although this may be true for some Canadians, for many others the incentive would be reduced. For the reasons outlined below, we recommend that the proposed integration scheme not be adopted.

75. To be workable, integration as proposed would require a general capital gains tax of the sort proposed by the White Paper, and we consider such a tax inappropriate at this point in the development of the Canadian economy.

76. To be workable, the integration proposal would also probably require the elimination of the low corporate tax rate which, as we have noted above, we do not consider to be in the best interests of the Canadian economy. It should be noted that, even if there were full integration, there would still be an increased tax burden on the corporation and, compared to the present system, for most mixes of shareholding there would be an increase in the combined current corporate and personal tax burden. Basically, integration would not relieve the problems of providing funds for growth and for the expansion of small companies.

77. Integration and the related capital gains proposal will introduce a wide range of problems and complexities, particularly with respect to stock dividends, the 2 1/2 year force-out rule and the distinction between closely-held and widely-held companies. This will give rise to a whole new set of conflicts — shareholder/shareholder, or shareholder/management interests and priorities — as well as additional administrative compliance problems. For example, the effect of the 2 1/2 year rule is that, after a short lag, all taxed earnings will have to be paid out annually by way of cash and/or stock dividends to prevent the tax credit from being lost to the shareholder. This will increase the pressure on some companies to enlarge dividend payments contrary to good business judgement. If cash is not available, the company will be pressed to pay stock dividends, thus unnaturally complicating its capital structure and penalizing resident shareholders with marginal tax rates in excess of 33—1/3 per cent who will have to dip into their personal resources to find the cash to pay tax currently on stock dividends.

78. Because of deficiencies of creditable tax, integration at the shareholder level would tend to

nullify incentives at the corporate level. Under the White Paper proposals, if a corporation happens to have an effective tax rate below 50 per cent due to incentives provided at the corporate level, then the shareholder's amount of creditable tax would be reduced. Some of these incentives would include the low rate for small businesses on the first $35,000 of income, incentive capital cost allowances in excess of book depreciation, depletion allowances, regional development and scientific research incentives. The proposals would, in effect, increase the personal tax burden on the shareholder and decrease his after-tax yield relative to the present tax credit system. The effect of the removal of the corporate incentive at the shareholder level is illustrated in the table below.

	Widely-held Company	
	Proposed System	Present Dividend Tax Credit System
Corporate earnings before tax	200	200
Corporate tax at, say, an effective rate of 30 per cent	60	60
Available and paid out as dividend	140	140
Taxable income of recipient	170(1)	140
Tax at, say, 50 per cent	85	70
Deduct: Tax credit 1/2 of underlying corporate tax	30	
20 per cent of dividend		28
Net tax payable	55	42
Net, after-tax retention	85	98

(1) Taxable income = amount of dividend, $140, plus $30 being 1/2 of the underlying corporation tax of $60.

79. If integration is adopted, dividends paid by one Canadian corporation to another will carry a risk of additional tax burden. Specifically, the redistribution by one Canadian company of dividends from a treaty-based controlled foreign corporation to a second Canadian shareholding company, or the receipt by such a company of dividends from another Canadian company, where in the aggregate, there is insufficient underlying creditable tax, will result in the receiving corporation paying tax where none is payable today. These provisions will tend to inhibit intercorporate investments, many of which generate economic efficiencies and will act as a disincentive to Canadian-based companies considering expansion abroad.

80. The White Paper's integration and tax credit proposals were held out as an aid to easier marketing of equities by business, on the basis that larger tax credits would make Canadian issues more attractive. We do not consider the proposals accomplish these goals.

(i) The need for equity funds generally coincides with a period of growth and expansion — a period also generally characterized by lower taxable income. During this period, creditable tax capable of being passed on to the shareholder will also be low and, as illustrated above, the after-tax yield will be reduced. This, we suggest, will increase the difficulty of obtaining equity financing for growing companies.

(ii) Factors other than tax generally exclude small businesses from the equity market, and it is not considered that the integration proposals will in any way improve the ability of small businesses to raise funds in this manner. Indeed, small companies will be discouraged by other White Paper proposals from "going public" because doing so will expose shareholders to capital gains tax on unrealized gains and to reduced creditable tax.

(iii) Only the shareholders of very large, mature, fully taxpaying Canadian companies will get the full benefits of enlarged dividend tax credits. Yet, these are the companies which have not had as much difficulty in gaining access to the equity market in the past.

81. While the mature, fully taxpaying company will carry full creditable tax and offer a higher after-tax yield to residents, the expanding growth company, particularly in the resource field, will tend to offer a relatively lower after-tax yield to residents. An unfortunate consequence of this will be that, if residents bid up the price of the mature companies and the price of the lower after-tax yield growth companies declines, the latter companies will tend to become even more attractive to non-residents.

82. We believe that integration as proposed will lead to strong pressures by other countries for Canada to provide tax credit refunds to their own residents. One may consider the case of France which, three years ago, adopted an integration scheme virtually identical

to the one now proposed for widely-held Canadian companies. Recently, the United States government successfully negotiated a treaty with France whereby, as of January 1, 1970, U.S. portfolio investors obtain from the French treasury corporate tax refunds referrable to their dividends. A resident of France receiving $100 dividend grosses up and takes $150 into income and claims $50 tax credit. A U.S. shareholder under the treaty receives $100 dividend from the French company and $50 from the French government (minus a normal 15 per cent withholding tax on the $150).

83. Basically, the United States position is that it is discriminatory not to give American investors the benefits of the credit for the corporate tax if the credit is given to domestic shareholders. Some of the United States treaty negotiating philosophy in this area was spelled out in a speech by the then Assistant Secretary of the Treasury, Stanley S. Surrey, before the National Foreign Trade Council in New York on November 1, 1967. He said:

> "The United States felt that if the allowance of the credit means that the French 50 per cent corporate tax is in part a shareholder tax, then domestically-owned French companies are paying a lower corporate tax rate than foreign — (including American) owned French companies, which is discriminatory in fact. If, on the other hand, the French corporate tax is a full 50 per cent and the credit instead represents a reduction in the shareholder tax on dividends, then, since the reduction eliminates such tax for the most part, the French should not claim a withholding tax on foreign shareholders. A withholding tax on foreign shareholders is but a counterpart to a domestic income tax on shareholders and, if that domestic tax does not exist, the assertion of a withholding tax is discriminatory."

84. The principle that the corporate tax is in part a shareholder's tax is explicitly stated in paragraph 1.42 of the White Paper. We believe that adoption of this principle will expose Canada to United States pressures to give tax credits to U.S. resident shareholders. On the other hand, the present dividend tax credit, which is available without regard to the underlying corporate tax, is an incentive for investment by Canadians in Canadian corporations and at the same time avoids U.S. pressures. The U.S. success with France will, we think, give the United States additional bargaining power in any treaty negotiation if integration is adopted in Canada. It must be emphasized that, if the United States were successful in negotiating a similar refund scheme from Canada, the Canadian treasury would be faced with a serious cash outflow problem.

85. The Association's response to the criticisms of the existing system listed in paragraph 4.18 of the White Paper is outlined below.

> "(1) Only part of the total tax due on the earnings of corporations is collected at the time that the earnings arise. (21 per cent is collected from small corporations immediately, and the shareholder's personal tax is collected only when the profits are distributed by the company to the shareholders.)"

Deferral is an appropriate incentive for growth in the small company. Small companies have more difficulties in competing and in access to research, technology, and financing.

> "(2) This delay in collecting the second instalment of tax gives shareholders — particularly shareholders of closely-held companies — time to grow accustomed to having the assets represented by the profits under their control, time to consider them as being their own. As a result, their resentment on payment of the second instalment of tax increases."

Almost everyone resents paying taxes but deferral of the second instalment of taxes is well recognized as an appropriate generator of funds for growth — particularly in small companies where access to financing is very limited.

> "(3) Also as a result of the delay they have time and reason to search for ways of avoiding the second tax."

Attempts to legally avoid payment of tax will always be with us. Improper avoidance of the second tax would now seem to be impossible because of legislation in force since 1963 which has been effectively supported by the courts.

> "(4) Because of the low rate, a taxpayer whose business can be incorporated can earn up to $40,000 at marginal rates of 21 per cent or less, but a taxpayer who cannot incorporate his source of income can earn only $5,000 before his marginal rate exceeds 21 per cent."

Many comments have been made by the government on a so-called unfairness of the low corporate rate available to 46,000-odd

incorporated "small" businesses in relation to the 450,000-odd unincorporated businesses. Of the 450,000, approximately 50,000 are admittedly unable to incorporate by virtue of professional status — for example, individual doctors, lawyers, accountants, architects, etc. The remaining 400,000, however, which have been quite free under the existing system to incorporate, have not done so. It is logical to presume that one of the main reasons unincorporated businesses do not incorporate is that most of them pay less total tax by being taxed as individuals than they would if taxed as corporations.

Furthermore, we note that this section deals with 'marginal rates' rather than average rates which we believe to be more relevant. For example, the 21 per cent corporate rate applies to every dollar of corporately generated income, whereas in an unincorporated business a considerable amount of income can be received before the average rate of tax on all income approaches 21 per cent. In short, we do not believe that an inequity exists as between the incorporated and the unincorporated small business.

"(5) By using a corporation, some taxpayers can ensure that none of their income need be exposed to the rates in excess of 50 per cent unless or until they need to withdraw the money from the company for personal use."

This deferral can equally be regarded as an appropriate incentive for saving, growth and risk-taking.

"(6) The dividend tax credit is of significantly greater value to high-income taxpayers than it is to low-income taxpayers."

The Table in paragraph 4.14 purports to demonstrate that the tax credit is of greater value to high-income taxpayers than it is to low-income taxpayers. We believe that a slightly different presentation of the same assumptions made by the White Paper will demonstrate that the dividend tax credit really gives a much lower percentage reduction in tax to the high-income person and a much greater percentage reduction in tax to the low-income person. This is illustrated below.

	Marginal Rate of the Taxpayer		
	20%	50%	80%
Dividend received	$100	$100	$100
Gross tax	20	50	80
Less: Dividend tax credit	20	20	20
Net tax payable	$ 0	$ 30	$ 60
Percentage reduction in tax on a dividend as a result of the dividend tax credit	100	40	25

"(7) The dividend tax credit is granted to shareholders of a Canadian company whether or not the company has paid enough Canadian corporate tax to cover the credit — indeed even if the company has not paid any Canadian corporate tax at all."

Basically, we believe that it is desirable to encourage Canadians to invest in shares of Canadian companies irrespective of whether the company happens to have reached a fully taxpaying position. A flat rate of dividend tax credit maintains Canadian incentive to acquire shares in expanding businesses and resource industry companies, and in Canadian companies which have foreign investment to complement their Canadian operations. Unlike the integration proposals, it does not tend to nullify at the shareholder level the incentives provided at the corporate level. Moreover, by divorcing the tax credit from the underlying corporation tax and accepting the notion that a flat dividend tax credit is merely an incentive for Canadians to invest in Canadian companies, the pressures from other countries to pay tax credit refunds to non-residents would be avoided.

86. Based on the foregoing, we believe that it is desirable for Canada to retain the flat rate dividend tax credit. We also think that having regard to the vast capital requirements of the next decade and the necessity of encouraging Canadians to invest in Canadian equities, it would be desirable to increase

the dividend tax credit from 20 per cent to 25 per cent.

87. It has been suggested that Canada should not provide a tax credit where the payor corporation has some foreign income which is not being taxed by Canada. On the other hand, it would appear that the government does not wish to discourage foreign investment by Canadian companies. This is inferred from the White Paper proposal to permit a flow-through credit of 15/85ths (approximately 17 1/2 per cent) in respect of foreign income. Foreign investment does, of course, enhance Canadian operations by participation in world markets and also as a long term positive contribution to our balance of payments position. Inasmuch as foreign income is generally only a small porportion of total corporate income, we do not think it is desirable to scale down the dividend tax credit in respect to foreign-source income.

88. A desirable feature of any tax system is that it is simple and easily understood. The present flat rate dividend tax credit is both. On the other hand, the integration/capital gains package is complex. The Association must emphasize this point, which it considers a compelling reason for the retention and expansion of the existing dividend tax credit system. and retention of the existing exemption for inter-corporate dividends. While we strongly disagree with the integration/capital gains package in the White Paper, in the ensuing paragraphs we offer comments in the event that some or all of those structural concepts are proceeded with.

89. The proposal that creditable tax must be allocated to the shareholder by way of cash or stock dividend within a 2 1/2 year period is unduly harsh. If the 2 1/2 year rule is adopted, management decisions will be more circumscribed and management will be faced with greater pressures. Certain shareholders receiving stock dividends will be subject to an immediate cash penalty. We suggest that this period should be increased to at least five years, but preferably ten years.

90. Insofar as stock dividends are concerned, we note that non-resident shareholders receiving stock dividends may be faced with the obligation of paying tax when they do not have the necessary cash to do so.

91. The paragraphs which follow set forth the Association's views on the proposals dealing with closely-held and widely-held corporations.

92. The White paper indicated that the Minister of National Revenue would, in certain circumstances, have the power to designate certain corporations as widely-held. To prevent this power from being arbitrarily applied, and to enable corporations to plan effectively, it is desirable that the criteria for such a designation should be clearly spelled out by the government at the earliest possible date.

93. We recommend that some mechanism be provided to permit a widely-held corporation to revert to a closely-held corporation. Future business circumstances may be such that this reversion is desirable and in this regard the present proposal is unduly restrictive.

94. As indicated above we have rejected the integration proposals but we do endorse the optional election for small businesses and subsidiary companies to be taxed on a partnership basis. We feel that where the partnership election is made there should be provision for the elimination of unrealized inter-company profits.

95. It should be recognized that certain organizations operating as an efficient integrated economic unit may have subsidiary companies in which there is also a minority third-party holding. Where, say, 75 per cent or more of the shares of a subsidiary company are held by a parent, it is considered that the partnership option should be available to the parent with respect to the subsidiary even if the minority interest in the subsidiary is such that the subsidiary is a widely-held corporation. Certainly the mere holding by the public of non-convertible preferred shares should not necessarily result in a widely-held designation.

96. Certain closely-held corporations, otherwise eligible for partnership status, may have a minority interest held by non-residents. In our opinion, the partnership option should be available for such corporations provided that the non-resident shareholders agree to file Canadian tax returns currently on their share of the profits.

97. The provisions in paragraphs 4.74 – 4.79 of the White Paper under the caption "Starting the System" may prove quite troublesome and not all of the implications of these proposals have been clearly identified. These sections propose to tax recapturable depreciation and unrealized inventory profits by way of a current reduction of creditable tax by some arbitrary factor over a term of years. Although goodwill is not explicitly mentioned in these sections, there are indications that goodwill existing at the

time of "starting the system" would also serve to reduce creditable tax after the system comes into effect. It would appear that these complex proposals are considered necessary by the government in order to achieve the mechanical symmetry and proper working of the capital gains/integration package.

98. In our opinion, the proposed current reduction of creditable tax constitutes a completely unreasonable penalty to the shareholder in respect of unrealized asset appreciation that occurred prior to Valuation Day, an appreciation that incidentally may never be realized. We recommend that there be no current reduction in creditable tax in respect of unrealized asset appreciation. If the government considers that a mechanical problem exists, perhaps it could be cured by a later adjustment of the cost basis of the shares if, as and when pre-Valuation Day appreciation is, in fact, realized.

99. Furthermore, we consider that there is need for greater timing flexibility in the implementation of these proposals. Certain corporations will require a lengthy period for capital reorganization in order to minimize the undue tax burdens which may fall on one or more of its classes of shareholders. This is particularly so for corporations which have preferred but not common shares widely-held and for corporations with significant foreign income. We recommend that the government be flexible in timing the implementation of the proposals.

100. The White Paper proposes that shareholders of taxpaying Canadian utilities not be given any tax credit benefits for the corporation tax paid. The federal government has put forward this proposal because it earmarks the corporation tax revenue it receives from these utilities as a specific transfer payment to a particular province. This is, we submit, irrelevant when taxing a shareholder of the corporation.

101. To achieve equity and neutrality, we believe that, if the integration scheme is adopted for shareholders of all other corporations, then tax credits should be available to shareholders of utilities. To do otherwise would increase the difficulty of raising capital funds, increase utility rates and discourage efficient private enterprise. It may be noted that many other transfer payments also come out of corporation tax revenues. Perhaps this is a matter for negotiation between the federal and provincial governments, but this does not change our opinion that shareholders of utility companies should be given tax credit for the corporation tax paid.

102. As far as the taxation of co-operatives is concerned, others will undoubtedly comment in detail on the proposed changes. It is sufficient, we think, for the Association to observe that the unfair competitive advantage which many large co-operatives have over taxpaying corporations will continue until the patronage dividend deduction is limited to cash dividends.

Business and Property Income

103. The CMA welcomes the proposal to provide for the deduction of capital expenditures which are not presently deductible and are sometimes called "nothings". Although goodwill is the only example of "nothings" mentioned in the White Paper we hope that the Government will indicate what other types of capital expenditures it would include before legislation is introduced. Expenditures which are recognized as current under normal accounting practices should be treated accordingly for tax purposes and only expenditures regarded as capital for accounting purposes should be included in the proposed new depreciation class. If, however, such things as interest on money borrowed to pay dividends were regarded as not laid out to earn income it should be possible to include that kind of non-deductible expenditure in the proposed new class. Since the type of expenditure in this class would differ from the type in the present capital cost classes, we recommend that the straight-line method of depreciation should be used for tax purposes.

104. Connected with the proposal to allow a write-off of the cost of goodwill through a new capital cost allowance is a proposal that the proceeds of the sale of goodwill be subject to tax. We are concerned about the discrimination which may arise under the proposals between the acquisition techniques of buying assets or buying shares and with the possible retroactive effect of these proposals in relation to the taxation of the early sales of goodwill in existence at the time of implementation.

105. The Association disagrees with the proposal that entertainment and related expenses be no longer deductible on the grounds that:

(a) such expenditures are for the most part made to earn income and are reasonable in the circumstances;

(b) the proposal would discriminate against businessmen insofar as it would not reach any such alleged abuses by persons not in the employ of a profit-making corporation;

(c) it is unreasonable that the proper use made of entertainment and related expenses by the majority of businesses should be subject to penalty because of abuse by the minority;

(d) entertainment of customers and attendance of employees at conventions of trade and technical associations are useful activities for most businesses and we think that abuses in this area can be dealt with under existing provisions in the law.

106. By serving notice that it intends a subsequent review of the capital cost allowance system, the Government has raised concern within the Association. The use of such phrases as "naturally at some cost in government revenue" and "some have suggested that they are too generous," we construe as an indication of future reductions in these allowances.

107. It is the Association's view that the fundamental alteration in business cash-flow arising from the White Paper as a whole is such as to make it mandatory that business know what changes might occur in the capital cost allowance cash-flow before it can reasonably be expected to give full consideration to the tax reform proposals.

108. The Association repeats its view that regular and special capital cost allowance provisions have acted as an incentive to taxpayers to modernize and improve their business facilities and that this incentive for expansion should be maintained and strengthened in the future.

109. The Association welcomes the proposal that "taxpayers be permitted at any time to write a class of assets down to the aggregate cost of the assets of that type still on hand" (5.18).

110. With respect to consolidated returns and business losses, it is appropriate that the Association restate the following paragraph from its 1967 submission to the Minister of Finance:

> "157. The Association in addition concurs with the proposed lengthening of the period during which business losses may be claimed, but suggests that the recommended restrictions in respect of the carry-back of losses are both unduly harsh and unduly restrictive, particularly in respect of the increased efficiency arising from changes in the type of business carried on by a taxpayer and the management of such business.
>
> "158. The Association also considers that a corporation carrying on a number of diversified business activities should be permitted to deduct losses from one segment of its operations against profits from its other business operations. In the Association's opinion the privilege of filing consolidated corporate tax returns should be optional and should be extended to include affiliated companies less than 100 per cent owned."

111. The Association is of the opinion that existing business loss provisions should be widened; indeed, there should be neither penalty nor restriction in allowing for deduction of business losses.

112. A provision permitting the deduction by filing consolidated returns would broaden the basis on which a corporation could deduct business losses. The partnership proposal would permit some groups of corporations to achieve the same result as they would under consolidated returns. However, the partnership proposal is based on narrow eligibility rules and would apply to a relatively small number of corporations.

Resource Industries

113. The Association considers that the proposed incentive package for the resource industries would be less than adequate to maintain the necessary growth or investment rate of these industries, both from the point of view of the level of domestic capital input and foreign capital importation. Foreign competition for risk capital is intensifying and foreign mineral bodies are being developed as a result of encouragement through tax incentive measures which are much more attractive for resource capital than are the Canadian tax reform proposals.

114. To ensure that Canada maintains its fair share of capital input in the resource industries the after-tax rates of return should not be widely disparate between Canada and other resource intensive countries. We believe, however, that with the proposed reduction in incentives, the point will have been reached when mineral capital would start to move to relatively more attractive mineral ventures outside Canada. This movement would accelerate as new resource discoveries outside Canada attracted more and more capital.

115. Since a very large percentage of Canadian minerals is exported, a slow down in growth means a potentially large loss of foreign exchange.

116. The encouragement of mineral investment in Canada must also produce a corresponding effect on secondary industry growth. Dr. Eric J. Hanson of the University of Alberta, an authority on this subject, has emphasized that strong resource industries provide direct feed lines to encourage the growth of secondary and tertiary industries, wholesale and retail trade, transportation facilities and equipment, the construction industry and a wide variety of supporting services.

117. It is hardly necessary to emphasize, by way of example, the extent to which petroleum investment has been responsible for the regional development of Western Canada. The mining industry has similarly been responsible for the development of many remote areas and communities throughout Canada. Today's exploration in both off-shore continental shelves, the search for resources in the far northern islands, the recent success in the Mackenzie Delta, and new mine developments in Ungava provide further examples of the resource industries' contribution to Canadian development. We submit therefore, that any reduction in resource industry incentives would be at odds with the Government's regional economic development program.

118. The Association does not agree with those who contend that the mineral industry does not carry its fair share of the burden of taxation. Having in mind the substantial contributions to government revenues through mining taxes, mineral tax, royalties and the very high risk payments for mineral rights, we submit it is neither fair nor reasonable to judge this high risk, capital intensive industry solely on the basis of income tax contributions.

Depletion

119. The proposed $1 of depletion for every $3 of defined expenditures up to a maximum of 33 1/3 per cent of net production income would, over the long term, represent a substantial reduction from the allowance available under the existing system. After extensive study and debate in the United States, the existing gross depletion rates on mining income are to be substantially retained in that country and the gross depletion rates on petroleum income will be 22 per cent. On the basis of the White Paper proposals, Canada would be providing depletion incentives substantially lower than those available in the United States. This would only increase the disadvantage Canadian companies already face in competition with their U.S. counterparts.

120. The rationale of the depletion allowance has been to encourage investors to put dollars into

projects in Canada that are abnormally risky. Without such an incentive, investors would not do so. To be successful, an incentive must provide sufficient reward for success to persuade an investor to accept the risks involved. In this context the strictly work-related depletion formula which is proposed can be seen as a very ineffective incentive.

New Mines.

121. Withdrawal of the three-year exemption for new mine income would be a severe impediment to the growth of outlying Canadian areas. Although no loss in tax dollars results from a mine that is never developed, the withdrawal of the existing incentives must be seen in terms of the loss of the Government's share of future earnings, and the loss of jobs that would have resulted, towns that would have been built, Canadian purchases that would have been made, services that would have been required if a mine had in fact been developed as a result of the present incentives.

122. The Association therefore recommends that the existing three-year exemption for new mine income should be retained.

Taxing International Income

123. The international income proposals seek to:

- create a climate hospitable to international flows of capital;
- allow Canadian companies to compete on the international scene without being subject to more onerous taxes than their competitors;
- open up opportunities for Canadian exporters;
- provide a tax-neutral climate toward Canadian investment abroad;
- prevent avoidance or postponement of Canadian tax by artificial means involving the use of international transactions.

124. We agree with these objectives, but we consider the proposals do not implement them for the following reasons:

(i) The capital gains and withholding tax proposals will tend to discourage foreign capital by directly reducing its returns.

(ii) The "passive income" proposals put a cloud over all foreign operations and are a direct threat to the competitiveness of Canadian firms, notably Canadian exporters, operating in foreign markets.

(iii) The restriction of dividend tax exemption to "treaty" countries is discriminatory toward countries which, as a matter of policy, do not engage in tax treaties. As it would increase the tax burden in specific investment situations, it has serious implications for the competitiveness of Canadian companies operating in non-treaty countries.

CONTROLLED FOREIGN CORPORATIONS

125. It is proposed that a foreign corporation will qualify as a controlled foreign corporation if 25 per cent or more of the voting shares are owned by a Canadian corporation. With this required ownership, dividends would be exempt if there were a tax treaty with the foreign country of residence. If there is less than 25 per cent stock ownership, the holding would be treated as a portfolio investment fully taxed with allowance up to 15 per cent for withholding tax only and no allowance for underlying corporate tax.

126. The "cut-off" point between controlled foreign corporation and portfolio status is set much too high when one considers the consequential differences in tax treatment.

127. As our economy grows, smaller Canadian exporters will increasingly tend to enter into international joint-venture arrangements in which they can offer only a small participation, frequently less than 25 per cent. Thus, the problem of less than 25 per cent holdings of genuine commercial interest will increase.

128. A portfolio holding which ought to be taxed with allowance only for withholding tax should be one which is held for return rather than as a commercial outlet device and is readily marketable, i.e., it is not so large as to be not readily disposable. The U.S.A. rule is that less than ten per cent interests are taxed on the portfolio basis. It is also relevant that many stock exchanges and securities control agencies require disclosure of acquisition of more than ten per cent in a company. This suggests that ten per cent is a more appropriate cut-off between portfolio and other commercial interest.

EXEMPTION OF DIVIDENDS RECEIVED FROM CONTROLLED FOREIGN CORPORATIONS

129. The proposal to limit exemption of dividends from controlled foreign corporations to those from countries with which Canada has a tax treaty appears without purpose and will be in the long run unworkable. The restriction is said to be required to frustrate efforts to use the dividend exemption artifically to reduce taxes on tax-haven income.

130. The treaty-exemption policy appears designed to encourage countries to negotiate. The problem is that there are a number of countries which will not agree to tax treaties for reasons of their own. Brazil, India, Mexico, Guatemala, Colombia and Venezuela are some examples. These countries have corporate income and withholding taxes which can bring the local tax rate at least equal to the Canadian rate so that no Canadian tax would be payable on dividends in some years. However, these countries also offer tax incentives for reinvestments so that, in many years, tax would be payable to Canada because of the tax sparing offered by the less developed country to induce investment.

131. Thus, the proposal in this regard will certainly be interpreted in some quarters as a form of fiscal discrimination by a developed country against a less developed country. This is particularly convincing in the cases mentioned since the funds for investments in these countries often will be mainly from retained earnings and local borrowings and not normally from infusions of new capital from Canada.

132. It is not necessary to limit dividend exemption by treaty in order to control the passive income tax avoidance problem and such limitations should be avoided. It creates more problems and more complex legislation than is needed.

133. If, despite the above arguments, such a limitation on dividend exemption is felt to be a genuine necessity, then we recommend:

(a) exemption be extended to dividends from controlled foreign corporations resident in such less developed non-treaty countries as are designated for this purpose by order-in-council;

(b) exemption be extended to dividends from such controlled foreign corporations resident in non-treaty, non-designated less developed countries in respect of which the Minister of Revenue has issued a determination valid for the period provided therein, that the company is not engaged in business so as artificially to avoid Canadian tax.

TAXATION OF DIVIDENDS FROM CONTROLLED FOREIGN CORPORATIONS

134. Foreign tax for credit purposes should be taken as the current tax accrued for the year of earnings irrespective of the tax year (as distinct from tax paid for the year) to which the tax applies. This will minimize constant adjustments in Canadian tax returns as foreign tax disputes are adjusted.

135. As indicated in the White Paper at paragraph 6.25 in respect of branch income, foreign tax credits in excess of those required to offset Canadian tax in one year should be permitted a carry-forward of five years and a carry-back of two years in order to average out tax payments over a period of time to reflect the impact of incentives, fast write-offs, etc.

136. In view of the potentially large sums involved, it will be imperative that the provincial income tax acts adopt substantially similar systems including allowance of credit for foreign tax paid irrespective of the foreign jurisdiction collecting the tax. Taxpayers may have large dividend earnings exposed to provincial income tax if the proposals are adopted without changes recommended here, since most foreign countries do not have a federal structure and a Canadian province presently allows tax credit only in respect of income tax imposed by junior levels of government.

137. It will be imperative to permit all taxable foreign dividends and related factors to be averaged together to obtain an overall average of "foreign tax", so that high tax bearing dividends can offset low tax bearing dividends from other places. The principle should be to tax foreign income in the aggregate, not on a selective basis since the selective formula will certainly result in a taxpayer being subject to an extremely high level of overall tax payments to its competitive injury.

PASSIVE INCOME OF CONTROLLED FOREIGN CORPORATIONS

138. Tax Avoidance

The White Paper notes with concern increased Canadian tax avoidance through the use of foreign corporations. Apparently it is proposed to create a new class of income to be called "foreign accrual income" which will be taxed in the hands of the Canadian "owners" as earned even though in the legal or accounting sense the income belongs to a controlled foreign corporation. It has not yet been made clear what kinds of income will be foreign accrual income, but reference is made in the White Paper to "dividends, interest, royalties and trans-shipment profits." We are told the legislation will be patterned generally on provisions of U.S.A. law.

139. The White Paper offers no data as to the magnitude of tax avoidance involved nor does it identify the numbers and types of avoidances so that it is difficult for the Association to assess both the problem and the proposed solution.

140. In 1962, the United States Congress enacted Sub-Part F of the Internal Revenue Code which deemed passive or "tainted" income to be immediately taxable in the hands of a U.S.A. parent as a phantom dividend. There were many complex rules and many escapes or safe havens to meet objections raised by legitimate enterprise. But the purpose was reasonably clear. One clear motive was to force repatriation of earnings for balance of payments reasons. Also, under U.S.A. law, dividends received by corporations were taxed with allowance for foreign tax credits. Congress felt that deferring tax was akin to avoiding tax, particularly where the money was reinvested abroad. So, again, they wished to force repatriation.

141. The balance of payments motive is not relevant in Canada's case. Likewise, tax avoidance by corporations is not an issue in the cases where dividends from controlled foreign corporations are now and will be tax-exempt. Their retained earnings are generally reinvested in plant or repatriated to Canada since there is no tax reason not to repatriate to Canada.

142. We can only assume that the tax avoidance complained of concerns private individuals who transfer assets to controlled corporations or trusts in low tax jurisdictions to avoid Canadian tax on the earnings (interest, dividends, etc.). We do not believe that Canadian widely-held corporations are or ought to be the target of this legislation. We believe they should be clearly exempted for the foregoing plus the following reasons:

(i) Such tax avoidance as may be attempted by these companies can be effectively policed by existing law dealing with pricing (Section 17), interest (Section 19), and those provisions dealing with artificial transactions generally.

(ii) Widely-held companies cannot effectively take personal income and estate tax motivation of individual shareholders into account in their foreign investment policies. They are subject to public disclosure.

(iii) The necessary complexity of this type of law will of necessity have a negative impact on export efforts and on the competitive position of Canadians in international commerce.

(iv) If there is uncertainty about the tax avoiding behaviour of large corporations in this area, it would seem wiser to introduce a five-year period of reporting of critical information around which convincing revenue protecting rules could be built.

143. **Defining Passive Income**

If the government is determined to apply the passive income rules to widely-held corporations then a policy problem will arise in defining the passive income in relation to bona fide business operations. Important reliefs and exemptions for bona fide operations are incorporated in the U.S.A. law in respect of passive income. Canada would have to consider adopting similar provisions as indicated in the following sections.

(a) **A "de minimis" Rule**

The U.S.A. law defines "passive income" as "foreign base company income." To avoid nuisance tax compliance problems, the U.S.A. Internal Revenue Code provides that "If the foreign base company income (of a controlled foreign corporation) is less than 30 per cent of gross income, no part of the gross of the taxable year shall be treated as foreign base company income." On the other hand, if the foreign base company income exceeds 70 per cent of the gross income, then the entire gross income (subject to specific exceptions) is treated as passive income (Section 954 (b) (3)). A similar and not less generous exemption would be necessary for Canada.

(b) **Definition of "Control"**

The U.S.A. Code defines a controlled foreign corporation for purposes of Sub-Part F to be any foreign corporation more than 50 per cent of the total combined voting power of which is owned by U.S.A. persons (only 25 per cent voting power being required in the case of a foreign corporation principally engaged in insurance of United States risks). In view of Canada's distinctly different policy problem in the area of foreign passive incomes, and in view of the complex compliance and conflict of interest problems created by this kind of law (i.e. dividend and investment policies, etc.) we strongly urge that 100 per cent control by Canadian interests be required. Clearly, any such rules should not apply to 25 per cent holdings because the control essential to tax avoidance activity is absent.

(c) **Trading and Services Income**

The U.S.A. Act defines as foreign base company income sales income derived by a foreign controlled corporation where:

(i) the sale is in connection with the purchase of personal property from a related person

and its sale to another or, vice versa, purchase from another and sale to a related person; and

(ii) the personal property was manufactured, etc. outside the country where the selling company is incorporated; and

(iii) the personal property is sold for use or consumption outside such country.

Similar rules are prescribed for services income comprising revenue from managerial, engineering, technical, etc. services performed on behalf of a related company outside the country where the seller is incorporated. Essentially, these rules in U.S.A. law treat as "passive income" profits earned by trading companies in international trade where affiliates are involved at either end of the trade. Because of the serious impact these rules could have on export trade, an additional sub-part was added to the Code (Sub-Part G) to reduce the taxable passive income created by this Section by a formula taking into account increases in export assets. Thus, if the passive profits are reinvested in export trade they escape taxation. Additional reliefs were also provided. We cannot see any reason for Canada to adopt such a package of legislation or, worse still, adopt the taxing provisions without reliefs. The defence against tax avoidance in this area lies in proper enforcement of the sections of existing Canadian law dealing with arms length pricing of goods and services.

(d) Shipping

The phrase "trans-shipment profits" could have reference to profits from shipping operations carried out by a controlled foreign corporation. By comparison, the U.S.A. Code provides a specific exception that "foreign base company income does not include income derived from, or in connection with, the use (or hiring or leasing for use) of any aircraft or vessel in foreign commerce . . . ." (Section 954)(b) (2)). A similar exception would be strongly recommended for Canada.

(e) Bona Fide Operations

A further important supporting provision found in the U.S.A. law is that foreign base company income does not include any item of income received by a controlled foreign corporation when neither the organization of the corporation nor the effecting of the transaction through the controlled foreign corporation has as one of its significant purposes a substantial reduction of income tax.

This provision is important to protect the controlled foreign corporation from taxation where, due to circumstances beyond its control, a major item of "passive income" is received in a year which takes it out of the de minimis class. A similar rule would be required for Canada.

We also strongly urge that the Canadian law reforms be aimed at preventing avoidance of only Canadian tax. They should not be designed to cast the Department of National Revenue in the role of international policeman to assure that all income is taxed somewhere.

WITHHOLDING TAXES

144. We recognize the motive in Canada increasing its withholding tax rates to achieve a basis for negotiation with other countries. However, in the long run, such action can only hinder the real mobility of capital. We favour, generally, the OECD principle that by bilateral agreement a ceiling rate of ten per cent is appropriate in respect of interest and a five per cent rate in respect of dividends paid by a controlled corporation to its non-resident parent.

CAPITAL GAINS

145. A full rate of tax on gains realized on the sale of shares in a controlled foreign corporation is wrong in principle since it contemplates taxation of purely inflation gain and undistributed income which (presumably) would have been exempt if remitted as dividends. Frequently, dividends are restricted by local law to a percentage of registered capital (as in Norway and Brazil). Thus, the surplus account is not at the free disposition of the Canadian parent. It is possible that such rules (or total restraint or repatriation for exchange control reasons) will cause the Canadian parent to sell some part or all of its interests.

146. Broad roll-over provisions are required to facilitate foreign corporate reorganizations (even where an element of barter is involved i.e. where a larger interest in corporation A is surrendered for a smaller interest in amalgamated corporation AB) because there will be no economic gain nor any opportunity for tax avoidance as may be thought in the Canadian context and thus no policy need to impose tax except on genuine realizations.

147. Another critical problem concerns tax treatment to be applied to expropriations on forced sales.

Canadian companies have major interests in less developed countries. Recent developments in some countries indicate the possibility of situations wherein the Canadian parent would be forced to sell some part or all of its interests in large going concerns to the host governments.

148. Taxation by Canada of capital gains realized or deemed realized by non-residents on Canadian shares would be contrary to internationally recognized taxation principles and would seriously affect Canada's ability to negotiate tax treaties. It would discriminate against the non-resident shareholder who would not have the offsetting reduction of Canadian tax through deductibility of capital losses. It would also be a strong deterrent against foreign equity investment in Canada. In view of almost certain retaliation by other countries, consideration should also be given to the reverse side of the proposal: Canada would have to allow full credit for foreign capital gains tax paid by Canadian residents on gains on foreign shares.

149. The proposed measure raises practical and administrative complexities not justified by its intended effect.

FOREIGN TAX CREDIT

150. The proposal to restrict the foreign tax credit on investment income to 15 per cent is a further discrimination against foreign investment. Many countries impose withholding tax in excess of 15 per cent on dividends and in view of the reduced treaty bargaining position of Canada that would result from the White Paper proposals, it is by no means certain that Canada would obtain a 15 per cent maximum on withholding taxes on dividends in its future treaties. This proposal requires careful re-examination.

Co-ordination with the Provinces

151. We welcome the proposal that the federal government continue its offer to collect provincial taxes, and we hope that agreement can be reached with Ontario and Quebec for the implementation of this proposal.

152. Although the White Paper emphasizes the freedom of the provinces to levy whatever level of tax they choose, the White Paper's projections assume that the provinces will charge 28 per cent of the amount of federal personal income tax (except Quebec) and corporation income tax rates of from 10 per cent to 13 per cent. Ontario, however, has already expressed its intention to increase its revenues from the personal income tax and the possibility that other provinces would do likewise makes it difficult to evaluate the proposals.

153. The White Paper notes that changes in provincial laws would be required to give credit to individual shareholders for the provincial share of the income taxes paid by corporations. Further changes in provincial laws would be required to make effective the proposal to give credit for foreign tax paid by a controlled foreign corporation incorporated in a non-treaty country.

154. We recommend early and conclusive discussion with the provinces, for until we know the provinces' intentions on all these matters, a full evaluation of the proposals cannot be made.

APPENDIX "B"

NAME: <u>THE CANADIAN MANUFACTURERS' ASSOCIATION</u>

SUBJECT: White Paper Proposals.

Analysis of Appendix "A" by Senior Advisor

This brief is submitted by The Canadian Manufacturers' Association, a non profit, non political organization of some 7,700 members in every branch of manufacturing industry throughout Canada.

The brief deals with the following subjects:

1. Individuals (Pages 10 and 11)
   - (a) Deductions for child care, employee's moving expenses, unemployment insurance premiums.
   - (b) Increased rates of taxes.
   - (c) Disparity between Canadian and United States rates of taxes.
   - (d) Averaging formula.
   - (e) Pension and retirement saving plans.

2. Capital gains (Pages 12 to 14)

3. Corporations and their shareholders (Pages 15 to 21)
   - (a) Low rate of tax on small corporations.
   - (b) Integration.

4. Business and Property Income (Pages 22 and 23)
   - (a) Deduction for "nothings".
   - (b) Entertainment and related expenses.
   - (c) Capital cost allowances.
   - (d) Consolidated returns.
   - (e) Business losses.

5. Resource Industries (Pages 24 and 25)

(a) Depletion.

(b) New mines.

6. International Income (Pages 26 to 30)

(a) Controlled foreign corporations.

(b) Passive income.

(c) Withholding taxes.

(d) Capital gains.

(e) Foreign tax credit.

7. Co-ordination with the Provinces (Page 31)

The attention of the Committee is drawn to the following comments:

1. "The Association disagrees with the priorities implicit in the White Paper's statement: "The second main objective of tax reform is to see that the tax system does not interfere seriously with economic growth and productivity" (1.10). We consider that priority should be given to the objective of economic growth which goes hand in hand with improving the quality of life. We believe that the benefits of improved equity should follow and complement rather than appear as alternative to gains resulting from a steady and balanced expansion of output."
(Page 3, paragraph 6 of the brief).

2. "We consider that the White Paper must be criticized on four fundamental grounds:

(a) It proposes an overall level of taxation and government expenditure which are compatible with our present stage of development and our need to remain internationally competitive;

(b) It proposes shifts in the incidence of taxation - individual and corporate - that will penalize initiative and repress capital investment;

(c) It is incomplete in that it proposes nothing about other forms of taxes, such as commodity taxes and estate duties;

(d) It is inconsiderate of the needs of junior governments for tax revenues and

could lead to a tax jungle in which any move toward the federal objectives of equity and neutrality is completely thwarted."

(Pages 3 and 4, paragraph 7 of the brief)

3. "However, we are gravely concerned about the proposed increases in the tax rate of middle income earners, i.e. taxpayers earning between $9,100 and $24,000 per annum. The Association recommends that every effort should be made to reduce the impact on these taxpayers."

(Page 4, paragraph 8 of the brief)

4. "We are also concerned to note that the authors of the White Paper intend to deal separately with the capital cost allowance system. We consider that the Government's intentions in relation to the capital cost allowance system and in relation to sales taxes should be made known as soon as possible so that they can be considered jointly with the White Paper proposals."

(Page 4, paragraph 15 of the brief)

5. "The capital gains and withholding tax proposals would reduce the attractiveness of investment by non-residents in Canada."

(Page 4, paragraph 17 of the brief)

6. "The "passive income" proposals would be a threat to selling efforts vital to Canadian exports and the proposed distinction in the treatment of income from controlled foreign corporations depending on whether the corporation is in a treaty or non-treaty country, is not justified."

(Page 4, paragraph 18 of the brief)

7. "The Association welcomes the proposal that the Federal government will continue to collect provincial income taxes and hopes that agreement can be reached with the provinces for the implementation of this proposal."

(Page 4, paragraph 19 of the brief)

8. "We note that the White Paper projections assume that the provinces will be satisfied with 28% of the federal personal income tax (higher in Quebec) and 10-13% corporate income tax. Until the provinces indicate that they are satisfied with these assumptions, we consider that it is difficult to assess the White Paper and urge that agreement should be reached with the provinces on these matters as soon as possible."
(Page 4, paragraph 20 of the brief)

9. "In particular, the White Paper ignores sales taxes and it merely serves notice that there will be a subsequent review of capital cost allowances. The ommission of these two important features from an outline of a reformed tax system makes it very difficult, if not impossible, to anticipate the full impact of the White Paper proposals. We believe that changes in the tax system of the magnitude proposed in the White Paper should not be dealt with in isolation. Yet, last year's changes to estate and gift taxes and the introduction of taxes on life insurance investment income and profits appear to indicate that this is precisely the Government's intention."
(Page 6, paragraph 29 of the brief)

10. "According to the White Paper, the proposals would have only a "relatively modest impact upon the Canadian economy" (8.35). The Association cannot accept this assertion, particularly in view of the shifts in the incidence of taxation and the reductions in the rate of saving and investment which would follow the implementation of the proposed tax measures. Both types of change would have a significantly negative effect on the rate of economic growth."
(Pages 3 and 7, paragraph 32.)

11. "The Association is of the view that the White Paper is open to criticism on four fundamental grounds:

(a) It proposes an overall level of taxation and government expenditure which are incompatible with our present stage of development and our need to remain internationally competitive;

(b) It proposes shifts in the incidence of taxation - individual and corporate - that will penalize initiative and repress capital investment;

(c) It is incomplete in that it proposes nothing about other forms of taxes, such as commodity taxes and estate duties;

(d) It is inconsiderate of the needs of junior governments for tax revenues and could lead to a tax jungle in which any move toward the federal objectives of equity and neutrality is completely thwarted."

(Page 9, paragraph 46 of the brief)

12. "The taxation of capital gains realized (or deemed realized in some cases) by foreigners on Canadian investments would undoubtedly inhibit foreign investment in this country."
(Page 12, paragraph 59 of the brief)

13. "The Association also believes that the taxation of capital gains, accompanied by probable increased dividend payments by corporations to preserve tax credits to shareholders and the proposed increase in tax rates, would reduce private savings substantially. We expect many taxpayers, if not the majority, after paying higher taxes, would tend to dispose of their remaining income on consumer goods and services because incentives to save would be reduced. We doubt that the reduction in private savings will be as modest as the White Paper estimates."
(Page 12, paragraph 60 of the brief)

14. "To ensure that Canada maintains its fair share of capital input in the resource industries the after-tax rates of return should not be widely disparate between Canada and other resource intensive countries. We believe, however, that with the proposed reduction in

incentives, the point will have been reached when mineral capital would start to move to relatively more attractive mineral ventures outside Canada. This movement would accelerate as new resource discoveries outside Canada attracted more and more capital."
(Page 24, paragraph 114 of the brief)

15. "Since a very large percentage of Canadian minerals is exported, a slow down in growth means a potentially large loss of foreign exchange."
(Page 24, paragraph 115 of the brief)

16. "The Association does not agree with those who contend that the mineral industry does not carry its fair share of the burden of taxation. Having in mind the substantial contributions to government revenues through mining taxes, mineral tax, royalties and the very high risk payments for mineral rights, we submit it is neither fair nor reasonable to judge this high risk, capital intensive industry solely on the basis of income tax contributions."
(Page 24, paragraph 118 of the brief)

17. "We welcome the proposal that the federal government continue its offer to collect provincial taxes, and we hope that agreement can be reached with Ontario and Quebec for the implementation of this proposal. Although the White Paper emphasizes the freedom of the provinces to levy whatever level of tax they choose, the White Paper's projections assume that the provinces will charge 28 per cent of the amount of federal personal income tax (except Quebec) and corporation income tax rates of from 10 per cent to 13 per cent. Ontario, however, has already expressed its intention to increase its revenues from the personal income tax and the possibility that other provinces would do likewise makes it difficult to evaluate the proposals.

The White Paper notes that changes in provincial laws would be required to give credit to individual shareholders for the provincial share of the income taxes paid by corporations. Further changes in provincial laws would be required to make effective the proposal to give credit for foreign tax paid by a controlled foreign corporation incorporated in a non-treaty country.

We recommend early and conclusive discussion with the provinces, for until we know the provinces' intentions on all these matters, a full evaluation of the proposals cannot be made."

(Page 31, paragraphs 151 to 154 of the brief)

The brief makes several recommendations, these are:

1. The existing averaging formulae should be retained in those circumstances where they now apply and a more effective general averaging provision should be made available for all tax payers.
(Page 4, paragraph 9 of the brief)

2. "The Association is not convinced that a capital gains tax is desirable at this time in Canada. However, when Canada reaches a stage of economic development where capital requirements of a full employment economy can be provided at reasonable rates from private savings, it may be appropriate to tax capital gains. Such a tax should be imposed gradually and should be at a much lower rate than that proposed in the White Paper and should be contained in a separate rate schedule."
(Page 4, paragraph 10 of the brief)

3. "Insofar as small businesses are concerned, the Association disagrees with the White Paper's proposals to eliminate the low corporate tax rate on the first $35,000 of

all corporate taxable income. Smaller companies experience difficulties in accumulating capital for future growth and we suggest the retention of the incentive provided by the low corporate tax rate for companies with incomes under $250,000."
(Page 4, paragraph 11 of the brief)

4. "We disagree with the White Paper's proposal to integrate personal and corporate income and recommend that the existing dividend tax credit should be retained and increased from 20 per cent to 25 per cent."
(Page 4, paragraph 12 of the brief)

5. "We disagree with the proposal that entertainment and related expenses should no longer be deductible."
(Page 4, paragraph 14 of the brief)

6. "The Association considers that the proposal to phase out the three-year exemption for new mines and for depletion allowance to be "earned" would reduce the growth of the extractive industries with a resultant slow down in the growth of secondary industries and in our export income. The Association considers that the existing incentives should be continued."
(Page 4, paragraph 16 of the brief)

7. The Association recommends that the existing three year exemption for new mine income should be retained.
(Page 25, paragraph 122 of the brief)

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Income Averaging.

Present Tax Law	White Paper Proposals	Principal Points of Brief
	2.56 The method proposed is as follows: when the income in the taxation year exceeds the average of the taxpayer's income in the preceding four years by more than one-third, the excess income would be taxed as though it were subject to a graduated rate schedule in which the income brackets to which each rate applied were five times as wide as normal. The formula is necessarily complicated but this would not concern taxpayers because it can be applied on their behalf. Tables 11 and 12 show the application of the formula in more detail. 2.59 A second and more serious practical problem is whether years in which there is no taxable income for one reason or another should be counted for averaging, and whether years before such a year of no income should be used. It seems unfair to permit a taxpayer to include in averaging any years in which he or she is claimed as a dependant for purposes of the married exemption. The same is true of students at school or university. Counting such years of no income, or income below the exemption limit, might well reduce tax for several years on people who have chosen to be outside the labour market and in respect of whom dependants' deductions have been granted. It is therefore proposed that a married person may use for averaging only an unbroken series of years after being claimed as a dependant by his or her marriage partner. A person under 25 years of age could use only an unbroken series of years since the last year in which he had no tax to pay. These rules are not wholly satisfactory, but no simple and	Pages 10 and 11 of the brief. The brief makes the points that the formula will give little relief and recommends that: (a) a more effective general averaging provision should be made available to all tax payers. (b) there is good reasons for special averaging provisions for lump sum payments.

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Income Averaging.

Present Tax Law	White Paper Proposals	Principal Points of Brief
	practical alternative has been found. Those prevented by such rules from using more than, say, two previous years for averaging might be permitted to assume an arbitrary income of $5,000 per year in the years excluded.	

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Individual rates of tax.

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 10 and 11 of the brief. The brief agrees with the proposal of tax relief for people at the lower end of the income scale, but believes this should be done without further tax increases at other income levels. The brief is concerned with the increasing disparity between tax rates in Canada and the United States. The proposed tax increases on taxpayers earning more th an $9,000 discourages immigration and is not an encouragement for persons to remain in Canada.

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Deductions from earned income.

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 10 and 11 of the brief. The brief agrees with the proposal to permit the deduction of child care expenses and of costs to employees of earning income. The brief recommends that a 1. carry over should be permitted for moving expenses incurred late in the year. 2. the 3% deduction should not be applied to medical expenses otherwise deductible.

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Pension and Retirement Savings Plans.

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 10 and 11 of the brief. The brief submits that: 1. no tax should be payable on pensions arising from contributions which were not allowed as a deduction which made. 2. the proposed right of a widow to reduce or offset income by contributions to a registered savings plan should be extended to other beneficiaries. 3. the proposal that no more than 10% of the assets of a pension plan can be invested in foreign securities should be withdrawn. 4. the proposal to withhold tax from pension payments should only be applied when credit can be obtain in country of residence.

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Capital Gains

Present Tax Law	White Paper Proposals	Principal Points of Brief
	The White Paper proposals on capital gains are contained in Chaper 3 of the White Paper.	Pages 12 to 14 of the brief. The brief points out: 1. the adverse effects of a capital gains tax on savings of Canadians 2. the possibility of transfer of investment in Canadian securities to foreign securities 3. the possibility of loss of control resulting from the need to raise funds to pay tax on a "deemed gain" 4. the tax is or may be a tax on inflationary gain and not on income 5. the practical problems of valuing assets on valuation day. The brief states: 63. "The Association believes that a capital gains tax is not appropriate in Canada at this stage of its economic growth. We note that a capital gains tax was only introduced in U.S.A. and the United Kingdom after their economies were well developed, and these tax systems still provided ample opportunities for the formation of private capital. Australia, with an economy comparable to that of Canada, does not have a capital gains tax." 64. "When Canada reaches a stage of economic development where capital requirements of a full employment economy can be provided at reasonable rates from private savings, it may be appropriate to introduce a tax on capital gains. Such a tax should be imposed gradually and should be much less severe than that proposed by the White Paper. If at some future date it is appropriate to introduce such a tax, the Association recommends that the following specific amendments to the White Paper proposals be made:

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Capital Gains (Continued)

Present Tax Law	White Paper Proposals	Principal Points of Brief
		(i) The rate should be substantially lower and should be set out in a separate rate schedule. Ventures in the nature of trade should continue to be taxed as ordinary income as they are under the present tax system. (ii) A more equitable system of averaging should be devised. (iii) The gains should be adjusted by an index, similar to the consumer price index, to determine the true gain in terms of constant dollars. (iv) Gains arising from the sale of personal objects and hobby items should be exempt because enforcement of a gains tax on such items would be impossible and because these items seldom represent investment goods. (v) The roll-over privilege should be extended to business property acquired to replace existing property. This would remove penalties that might otherwise apply to growing businesses which find it necessary to move to new locations for expansion purposes. (vi) The tax should not apply to a taxpayer's principal residence because it would inhibit taxpayers adjusting their accommodation to suit their needs and would raise a further obstacle to home ownership. Moreover, a person's residence is in the nature of a consumption item rather than an investment item. The White Paper recognizes this in refusing to allow losses of carrying charges on residences to be deducted from other income. Consistency should entail the exemption of gains on a taxpayer's principal residence from a capital gains tax (vii) The quinquennial valuation and taxation proposal should be abandoned. Tax should apply only to gains realized on the sale of shares in widely held Canadian companies. The Association's reasoning on this point is previously stated.

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Principal Subject: Capital Gains (continued)

Present Tax Law	White Paper Proposals	Principal Points of Brief
		(viii) To avoid the taxation of gains after valuation day which in reality are only the recovery of losses accrued between the date of acquisition and the date of valuation, taxpayers should be permitted to deduct from proceeds of sales the greater of either the original cost or valuation day value.
		(ix) To avoid a double penalty of taxes on capital in the form of death, gift and capital gains taxes, rates of estate and gift taxes should be greatly reduced. In the Ontario Government's 1969 budget paper on proposed tax reform, it is stated that the need for the taxation of estates should diminish as the capital gains tax becomes effective and, therefore, estate taxation should gradually be eliminated. Sale of residences represent the major portion of the individual's lifelong savings for their retirement years
		(x) The use of stock ownership plans, particularly by smaller companies with growth potential, has been a valuable aid in securing highly skilled technical and managerial personnel necessary for the success of an enterprise. The prospect of realizing a tax-free capital gain provided the incentive to put forth maximum effort to make the enterprise grow and prosper. The taxation of such gains would largely remove this incentive, thereby making it more difficult to encourage qualified personnel to abandon secure positions to assume the more risky tasks of building a new venture. Similarly, the present favourable tax treatment for benefits under stock option plans has been an important incentive for management and we consider this favourable tax treatment should be continued."

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Small businesses.

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 15 to 21 of the brief. The brief recommends that the present low rate of tax on the first $35,000 of corporate income be retained. We recommend against adoption of integration but, if integration is to be implemented, we urge the government to try to find some way to adjust the flow-through mechanics of creditable tax to accommodate the low rate. "72. We have already expressed the view that the overall corporate tax burden should be increased, in order to improve Canada's international competitiveness. We also note that removal of the low rate on the first $35,000 of corporate income represents an increase in the taxation of all corporations. Notwithstanding these factors, we believe that most manufacturers would not object to the removal of the low rate when the smaller company has grown to an income level where an increase in the tax rate from 21 per cent to 50 per cent would not have too great a relative impact on available funds for growth. Accordingly, we believe most "larger" companies would, in the interest of preserving growth opportunities for smaller companies, not object to the removal of the low rate on the first $35,000 when taxable income reaches, say, $250,000. At this income level, the payment of the extra $10,000 of tax represents an increase of just under 10 per cent in the tax bill. If the White Paper proposals are implemented, the tax bill for a company earning $35,000 would, after transition, be increased by 140 per cent - 150 per cent." "73. To avoid hardships where incomes fluctuate, we further suggest that the low rate be removed only if the average taxable income of, say, the three preceding years, exceeds $250,000. Where associated companies are involved, the low rate should disappear when the taxable incomes of the group aggregate to an average of $250,000. In this connection, we do not believe the current allegation that large corporations are able to carve themselves up into many small companies and obtain multiple advantage of the present low corporate rate. Legislation in effect since 1963, and backed by court decisions in favour of the Crown, has effectively

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Small businesses (continued)

Present Tax Law	White Paper Proposals	Principal Points of Brief
		prevented such abuses."

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION.

Principal Subject: Integration.

Present Tax Law	White Paper Proposals	Principal Points of Brief
	The White Paper proposals on integration are contained in Chaper 4 of the White Paper.	Page 15 to 21 of the brief. The brief points out that integration: (1) Would require among other things a capital gains tax, with which the Association is not in agreement. (2) Would require the elimination of the low rate of tax - - again with which the Association is not in agreement. (3) Will create a whole new set of conflicts between shareholders and management. (4) Would negate incentives. (5) Will or may bring strong pressures by other countries for Canada to provide tax credits to their own residents. One may consider the case of France which, three years ago, adopted an integration scheme virtually identical to the one now proposed for widely-held Canadian companies. Recently, the United States government successfully negotiated a treaty with France whereby, as of January 1, 1970, U.S. portfolio investors obtain from the French treasury corporate tax refunds referrable to their dividends. A resident of France receiving $100 dividend grosses up and takes $150 into income and claims $50 tax credit. A U.S. shareholder under the treaty receives $100 dividend from the French company and $50 from the French government (minus a normal 15 per cent withholding tax on the $150). Basically, the United State position is that it is discriminatory not to give American investors the benefits of the credit for the corporate tax if the credit is given to domestic shareholders. Some of the United States treaty negotiating philosophy in this area was spelled out in a speech by the then Assistant Secretary of the Treasury, Stanley S. Surrey, before the National Foreign Trade Council in New York on November 1, 1967. He said "The United States felt that if the allowance of the credit means that the French 50 per cent corporate tax is in part a shareholder tax, then domestically-owned French companies are paying a lower corporate

Name: — THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Integration. (continued)

Present Tax Law	White Paper Proposals	Principal Points of Brief
		tax rate than foreign - (including American) owned French companies, which is discriminatory in fact. If, on the other hand, the French corporate tax is a full 50 per cent and the credit instead represents a reduction in the shareholder tax on dividends, then, since the reduction eliminates such a tax for the most part, the French should not claim a withholding tax on foreign shareholders. A withholding tax on foreign shareholders is but a counterpart to a domestic income tax on shareholders and, if that domestic tax does not exist, the assertion of a withholding tax is discriminatory."
		(6) The Association's response to the criticisms of the existing system listed in paragraph 4.18 of the White Paper is outlined below: "(1) Only part of the total tax due on the earnings of corporations is collected at the time that the earnings arise. (21 per cent is collected from small corporations immediately, and the shareholder's personal tax is collected only when the profits are distributed by the company to the shareholders.)" Deferral is an appropriate incentive for growth in the small company. Small companies have more difficulties in competing and in access to research, technology, and financing. "(2) This delay in collecting the second instalment of tax gives shareholders - particularly shareholders of closely-held companies - time to grow accustomed to having the assets represented by the profits under their control, time to consider them as being their own. As a result, their resentment on payment of the second instalment of tax increases." Almost everyone resents paying taxes but deferral of the second instalment of taxes is well recognized as an appropriate generator of funds for growth - particularly in small companies where access to financing is very limited.

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Integration (continued)

Present Tax Law	White Paper Proposals	Principal Points of Brief
		"(3) Also as a result of the delay they have time and reason to search for ways of avoiding the second tax." Attempts to legally avoid payment of tax will always be with us. Improper avoidance of the second tax would now seem to be impossible because of legislation in force since 1963 which has been effectively supported by the courts. "(4) Because of the low rate, a taxpayer whose business can be incorporated can earn up to $40,000 at marginal rates of 21 per cent or less, but a taxpayer who cannot incorporate his source of income can earn only $5,000 before his marginal rate exceeds 21 per cent." Many comments have been made by the government on a so-called unfairness of the low corporate rate available to 46,000-odd incorporated "small" businesses in relation to the 450,000-odd unincorporated businesses. Of the 450,000, approximately 50,000 are admittedly unable to incorporate by virtue of professional status - for example, individual doctors, lawyers, architects, etc. The remaining 400,000, however, which have been quite free under the existing system to incorporate, have not done so. It is logical to presume that one of the main reasons unincorporated businesses do not incorporate is that most of them pay less total tax by being taxed as individuals than they would if taxed as corporations. Furthermore, we note that this section deals with "marginal rates" rather than average rates which we believe to be more relevant. For example, the 21 per cent corporate rate applies to every dollar of corporately generated income, whereas in an unincorporated business a considerable amount of income can be received before the average rate of tax on all income approaches 21 per cent. In short, we do not believe that an inequity exists as between the incorporated and the unincorporated small business."

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Principal Subject: Integration (continued)

Present Tax Law	White Paper Proposals	Principal Points of Brief

"(5) By using a corporation, some taxpayers can ensure that none of their income need be exposed to the rates in excess of 50 per cent unless they need to withdraw the money from the company for personal use."

This deferral can equally be regarded as an appropriate incentive for saving, growth and risk-taking.

"(6) The dividend tax credit is of significantly greater value to high-income taxpayers than it is to low-income taxpayers."

The Table in paragraph 4.14 purports to demonstrate that the tax credit is of greater value to high-income taxpayers than it is to low-income taxpayers. We believe that a slightly different presentation of the same assumptions made by the White Paper will demonstrate that the dividend tax credit really gives a much lower percentage reduction in tax to the high-income person and a much greater percentage reduction in tax to the low-income person. This is illustrated below:

	MARGINAL RATE OF THE TAXPAYER		
	20%	50%	80%
Dividend received	$100	$100	$100
Gross tax	20	50	80
Less: Dividend tax credit	20	20	20
Net tax payable	$ 0	$ 30	$ 60
Percentage reduction in tax on a dividend as a result of the dividend tax credit.	100	40	25

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Integration (continued)

Present Tax Law	White Paper Proposals	Principal Points of Brief
		"(7) The dividend tax credit is granted to shareholders of a Canadian company whether or not the company has paid enough Canadian corporate tax to cover the credit - indeed even if the company has not paid any Canadian corporate tax at all." Basically, we believe that it is desirable to encourage Canadians to invest in shares of Canadian companies irrespective of whether the company happens to have reached a fully taxpaying position. A flat rate of dividend tax credit maintains Canadian incentive to acquire shares in expanding businesses and resource industry companies, and in Canadian companies which have foreign investment to complement their Canadian operations. Unlike the integration proposals, it does not tend to nullify at the shareholder level the incentives provided at the corporate level. Moreoever, by divorcing the tax credit from the underlying corporation tax and accepting the notion that a flat dividend tax credit is merely an incentive for Canadians to invest in Canadian companies, the pressures from other countries to pay tax credit refunds to non-residents would be avoided. The brief recommends as follows: "Based on the foregoing, we believe that it is desirable for Canada to retain the flat rate dividend tax credit. We also think that having regard to the vast capital requirements of the next decade and the necessity of encouraging Canadians to invest in Canadian equities, it would be desirable to increase the dividend tax credit from 20 per cent to 25 per cent. A desirable feature of any tax system is that it is simple and easily understood. The present flat rate dividend tax credit is both. On the other hand, the integration/capital gains package is complex. The Association must emphasize this point, which it considers a compelling reason for the retention and expansion of the existing dividend tax credit system, and the retention of the

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Principal Subject: Integration.

Present Tax Law	White Paper Proposals	Principal Points of Brief
		existing exemption for inter-corporate dividends. While we strongly disagree with the integration/capital gains package in the White Paper, in the ensuing paragraphs we offer comments in the event that some or all of those structural concepts are proceeded with. The White Paper indicated that the Minister of National Revenue, would in certain circumstances, have the power to designate certain corporations as widely-held. To prevent this power from being arbitrarily applied, and to enable corporations to plan effectively, it is desirable that the criteria for such a designation should be clearly spelled out by the government at the earliest possible date. We recommend that some mechanism be provided to permit a widely-held corporation to revert to a closely-held corporation. Future business circumstances may be such that this reversion is desirable and in this regard the present proposal is unduly restrictive. As indicated above we have rejected the integration proposals but we do endorse the optional election for small businesses and subsidiary companies to be taxed on a partnership basis. We feel that where the partnership election is made there should be provision for the elimination of unrealized inter-company profits It should be recognized that certain organizations operating as an efficient integrated economic unit may have subsidiary companies in which there is also a minority third-party holding. Where, say, 75 per cent or more of the shares of a subsidiary company are held by a parent, it is considered that the partnership option should be available to the parent with respect to the subsidiary even if the minority interest in the subsidiary is such that the subsidiary is a widely-held corporation. Certainly the mere holding by the public of non-convertible preferred shares should not necessarily result in a widely-held designation.

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Principal Subject: Integration (continued)

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Certain closely-held corporations, otherwise eligible for partnership status, may have a minority interest held by non-residents. In our opinion, the partnership option should be available for such corporations provided that the non-resident shareholders agree to file Canadian tax returns currently on their share of the profits. The provisions in paragraphs 4.74 - 4.79 of the White Paper under the caption "Starting the System" may prove quite troublesome and not all of the implications of these proposals have been clearly identified. These sections propose to tax recapturable depreciations and unrealized inventory profits by way of a current reduction of creditable tax by some arbitrary factor over a term of years. Although goodwill is not explicitly mentioned in these sections, there are indications that goodwill existing at the time of "starting the system" would also serve to reduce creditable tax after the system comes into effect. It would appear that these complex proposals are considered necessary by the government in order to achieve the mechanical symmetry and proper working of the capital gains/integration package. In our opinion, the proposed current reduction of creditable tax constitutes a completely unreasonable penalty to the shareholder in respect of unrealized asset appreciation that occurred prior to Valuation Day, an appreciation that incidentally may never be realized. We recommend that there be no current reduction in creditable tax in respect of unrealized asset appreciation. If the government considers that a mechanical problem exists, perhaps it could be cured by a later adjustment of the cost basis of the share if, as and when pre-Valuation Day appreciation is, in fact, realized. Furthermore, we consider that there is need for great timing flexibility in the implementation of these proposals. Certain corporations will require a lengthy period for capital reorganization in order to minimize the undue tax burdens which may fall on one or more of its classes of shareholders. This is particularly so for corporations which have preferred but not common shares widely-held and for

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Principal Subject: Integration (continued).

Present Tax Law	White Paper Proposals	Principal Points of Brief
		corporations with significant foreign income. We recommend that the government be flexible in timing the implementation of the proposals. The White Paper proposes that shareholders of taxpaying Canadian utilities not be given any tax credit benefits for the corporation tax paid. The federal government has put forward this proposal because it earmarks the corporation tax revenue it receives from these utilities as a specific transfer payment to a particular province. This is, we submit, irrelevant when taxing a shareholder of the corporation. To achieve equity and neutrality, we believe that, if the integration scheme is adopted for shareholders of all other corporations, then tax credits should be available to shareholders of utilities. To do otherwise would increase the difficulty of raising capital funds, increase utility rates and discourage efficient private enterprise. It may be noted that many other transfer payments also come out of corporation tax revenues. Perhaps this is a matter for negotiation between the federal and provincial governments, but this does not change our opinion that shareholders of utility companies should be given tax credit for the corporation tax paid. As far as the taxation of co-operatives is concerned, others will undoubtedly comment in detail on the proposed changes. It is sufficient, we think, for the Association to observe that the unfair competitive advantage which many large cooperatives have over taxpaying corporations will continue until the patronage dividend deduction is limited to cash dividends."

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Principal Subject: Deductions for Nothings.

Present Tax Law	White Paper Proposals	Principal Points of Brief
	5.5 The government proposes to create a new depreciation class which would sweep up all of these nothings and which would enable the taxpayer to deduct 10 per cent of the book value of this class each year. We believe that the 10-per-cent rate is fair if one takes into account the type of expenditure to be included.	Pages 22 and 23 of the Brief The Brief agrees with the proposal to permit the amortization of "nothings" and comments as follows: "Connected with the proposal to allow a write-off of the cost of goodwill through a new capital cost allowance is a proposal that the proceeds of the sale of goodwill be subject to tax. We are concerned about the discrimination which may arise under the proposals between the acquisition techniques of buying assets or buying shares and with the possible retroactive effect of these proposals in relation to the taxation of the early sales of goodwill in existence at the time of implementation."

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Deductions - Entertainment Expenses

Present Tax Law	White Paper Proposals	Principal Points of Brief
	1.35 Various fringe benefits received by employees or by the owners of businesses would be included in income for the first time. For example, an employee or owner of a business with a business-owned car available for his personal use would be required to include a minimum amount in his taxable income unless he pays the business at least that amount for the use of the car. There are other fringe benefits whose value cannot readily be measured in the hands of the recipient; for example, the use of hunting and fishing lodges, yachts and airplanes, the payment of social and recreational club dues, and the entertainment costs that are included in expense accounts. These costs would no longer be deductible to the employer. 5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.	Pages 22 and 23 of the Brief "The Association disagrees with the proposal that entertainment and related expenses be no longer deductible on the grounds that: (a) such expenditures are for the most part made to earn income and are reasonable in the circumstances; (b) the proposal would discriminate against businessmen insofar as it would not reach any such alleged abuses by persons not in the employ of a profit-making corporation; (c) it is unreasonable that the proper use made of entertainment and related expenses by the majority of businesses should be subject to penalty because of abuse by the minority; (d) entertainment of customers and attendance of employees at conventions of trade and technical associations are useful activities for most businesses and we think that abuses in this area can be dealt with under existing provisions in the law."

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Capital Cost Allowances

Present Tax Law

White Paper Proposals

5.14 The system has without doubt proven easy to comply with, and has caused far fewer difficulties between taxpayer and taxgatherer than the more usual "straight-line" system that preceded it in 1948 and earlier years. One of the reasons that it works so well may be because, on balance, the rates tend to be on the generous side. This generosity has acted as an incentive to taxpayers to modernize and improve their business facilities, but naturally at some cost in government revenue. The royal commission did not recommend reductions in depreciation rates. Perhaps for that reason, the rates were not generally an issue in the public debate on tax reform that has taken place over the past two years. Nevertheless some have suggested that they are too generous, and the government believes that after 20 years of the system it is time for a review. However, depreciation is an important aspect of the tax system and taxpayers should have an opportunity to put forward their views and experience before major changes are considered. Therefore, the government intends in due course to invite briefs on the system and rates of capital cost allowance.

Principal Points of Brief

Pages 22 and 23 of the Brief

"By serving notice that it intends a subsequent review of the capital cost allowance system, the Government has raised concern within the Association. The use of such phrases as "naturally at some cost in Government revenue" and "some have suggested that they are too generous," we construe as an indication of future reductions in these allowances.

It is the Association's view that the fundamental alteration in business cash-flow arising from the White Paper as a whole is such as to make it mandatory that business know what changes might occur in the capital cost allowance cash-flow before it can reasonably be expected to give full consideration to the tax reform proposals.

The Association repeats its view that regular and special capital cost allowance provisions have acted as an incentive to taxpayers to modernize and improve their business facilities and that this incentive for expansion should be maintained and strengthened in the future.

The Association welcomes the proposal that "taxpayers be permitted at any time to write a class of assets down to the aggregate cost of the assets of that type still on hand" (5.18).

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Consolidated Returns and Business Losses.

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 22 and 23 of the Brief With respect to consolidated returns and business losses, it is appropriate that the Association restate the following paragraph from its 1967 submission to the Minister of Finance: "157. The Association in addition concurs with the proposed lengthening of the period during which business losses may be claimed, but suggests that the recommended restrictions in respect of the carry-back of losses are both unduly harsh and unduly restrictive, particularly in respect of the increased efficiency arising from changes in the type of business carried on by a taxpayer and the management of such business. "158. The Association also considers that a corporation carrying on a number of diversified business activities should be permitted to deduct losses from one segment of its operations against profits from its other business operations. In the Association's opinion the privilege of filing consolidated corporate tax returns should be optional and should be extended to include affiliated companies less than 100 per cent owned." "The Association is of the opinion that existing business loss provisions should be widened; indeed, there should be neither penalty nor restriction in allowing for deduction of business losses. A provision permitting the deduction by filing consolidated returns would broaden the basis on which a corporation could deduct business losses. The partnership proposal would permit some groups of corporations to achieve the same result as they would under consolidated returns. However, the partnership proposal is based on narrow eligibility rules and would apply to a relatively small number of corporations."

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Resource Industries - depletion

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 24 and 25 of the Brief **Depletion** "119. The proposed $1 of depletion for every $3 of defined expenditures up to a maximum of 33 1/3 per cent of net production income would, over the long term, represen a substantial reduction from the allowance available under the existing system. After extensive study and debate in the United States, the existing gross depletion rates on mining income are to be substantially retained in that country and the gross depletion rates on petroleum income will be 22 per cent. On the basis of the White Paper proposals, Canada would be providing depletion incentives substantially lower than those available in the United States. This would only increase the disadvantage Canadian companies already face in competition with their U.S. counterparts. 120. The rationale of the depletion allowance has been to encourage investors to put dollars into projects in Canada that are abnormally risky. Without such an incentive, investors would not do so. To be successful, an incentive must provide sufficient reward for success to persuade an investor to accept the risks involved. In this context the strictly work-related depletion formula which is proposed can be seen as a very ineffective incentive."

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: Resource Industries - New Mines

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 24 and 25 of the Brief "Withdrawal of the three-year exemption for new mine income would be a severe impediment to the growth of outlying Canadian areas. Although no loss in tax dollars results from a mine that is never developed, the withdrawal of the existing incentives must be seen in terms of the loss of the Government's share of future earnings, and the loss of jobs that would have resulted, towns that would have been built, Canadian purchases that would have been made, services that would have been required if a mine had in fact been developed as a result of the present incentives. The Association therefore recommends that the existing three-year exemption for new mine income should be retained."

Name: **THE CANADIAN MANUFACTURERS' ASSOCIATION**

Principal Subject: International Income
Controlled Foreign Companies

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 26 to 30 of the Brief CONTROLLED FOREIGN CORPORATIONS "125. It is proposed that a foreign corporation will qualify as a controlled foreign corporation if 25 per cent or more of the voting shares are owned by a Canadian corporation. With this required ownership, dividends would be exempt if there were a tax treaty with the foreign country of residence. If there is less than 25 per cent stock ownership, the holding would be treated as a portfolio investment fully taxed with allowance up to 15 per cent for withholding tax only and no allowance for underlying corporate tax. 126. The "cut-off" point between controlled foreign corporation and portfolio status is set much too high when one considers the consequential differences in tax treatment. 127. As our economy grows, smaller Canadian exporters will increasingly tend to enter into international joint-venture arrangements in which they can offer only a small participation, frequently less than 25 per cent. Thus, the problem of less than 25 per cent holdings of genuine commercial interest will increase. 128. A portfolio holding which ought to be taxed with allowance only for withholding tax should be one which is held for return rather than as a commercial outlet device and is readily marketable, i.e., it is not so large as to be not readily disposable. The U.S.A. rule is that less than ten per cent interests are taxed on the portfolio basis. It is also relevant that many stock exchanges and securities control agencies require disclosure of acquisition of more than ten per cent in a company. This suggest that ten per cent is a more appropriate cut-off between portfolio and other commercial interest. EXEMPTION OF DIVIDENDS RECEIVED FROM CONTROLLED FOREIGN CORPORATIONS 129. The proposal to limit exemption of dividends from controlled foreign corporations to those from countries with which Canada has a tax treaty appears without purpose and

Name: **THE CANADIAN MANUFACTURERS' ASSOCIATION**

Principal Subject: International Income
Controlled Foreign Companies (Cont'd)

Present Tax Law	White Paper Proposals	Principal Points of Brief
		will be in the long run unworkable. The restriction is said to be required to frustrate efforts to use the dividend exemption artificially to reduce taxes on tax-haven income. 130. The treaty-exemption policy appears designed to encourage countries to negotiate. The problem is that there are a number of countries which will not agree to tax treaties for reasons of their own. Brazil, India, Mexico, Guatemala, Colombia, and Venezuela are some examples. These countries have corporate income and withholding taxes which can bring the local tax rate at least equal to the Canadian rate so that no Canadian tax would be payable on dividends in some years. However, these countries also offer tax incentives for reinvestments so that, in many years, tax would be payable to Canada because of the tax sparing offered by the less developed country to induce investment. 131. Thus, the proposal in this regard will certainly be interpreted in some quarters as a form of fiscal discrimination by a developed country against a less developed country. This is particularly convincing in the cases mentioned since the funds for investments in these countries often will be mainly from retained earnings and local borrowings and not normally from infusions of new capital from Canada. 132. It is not necessary to limit dividend exemption by treaty in order to control the passive income tax avoidance problem and such limitations should be avoided. It creates more problems and more complex legislation than is needed. 133. If, despite the above arguments, such a limitation on dividend exemption is felt to be a genuine necessity, then we recommend: (a) exemption be extended to dividends from controlled foreign corporations resident in such less developed non-treaty countries as are designated for this purpose by order-in-council; (b) exemption be extended to dividends from such controlled foreign corporations resident in non-treaty, non-designated less developed countries in respect

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Principal Subject: International Income
Controlled Foreign Companies (Cont'd)

Present Tax Law	White Paper Proposals	Principal Points of Brief
		of which the Minister of Revenue has issued a determination valid for the period provided therein, that the company is not engaged in business so as artificially to avoid Canadian tax. TAXATION OF DIVIDENDS FROM CONTROLLED FOREIGN CORPORATIONS 134. Foreign tax for credit purposes should be taken as the current tax accrued for the year of earnings irrespective of the tax year (as distinct from tax paid for the year) to which the tax applies. This will minimize constant adjustments in Canadian tax returns as foreign tax disputes are adjusted. 135. As indicated in the White Paper at paragraph 6.25 in respect of branch income, foreign tax credits in excess of those required to offset Canadian tax in one year should be permitted a carry-forward to five years and a carry-back of two years in order to average out tax payments over a period of time to reflect the impact of incentives, fast write-offs, etc. 136. In view of the potentially large sums involved, it will be imperative that the provincial income tax acts adopt substantially similar systems including allowance of credit for foreign tax paid irrespective of the foreign jurisdiction collecting the tax. Taxpayers may have large dividend earnings exposed to provincial income tax if the proposals are adopted without changes recommended here, since most foreign countries do not have a federal structure and a Canadian province presently allows tax credit only in respect of income tax imposed by junior levels of government. 137. It will be imperative to permit all taxable foreign dividends and related factors to be averaged together to obtain an overall average of "foreign tax", so that high tax bearing dividends can offset low tax bearing dividends from other places. The principle should be to tax foreign income in the aggregate, not on a selective basis since the selective formula will certainly result in a taxpayer being subject to an extremely high level of overall tax payments to its competitive injury.

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: International Income
Passive Income

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 26 to 30 of the Brief PASSIVE INCOME OF CONTROLLED FOREIGN CORPORATIONS 138."Tax Avoidance The White Paper notes with concern increased Canadian tax avoidance through the use of foreign corporations. Apparently it is proposed to create a new class of income to be called "foreign accrual income" which will be taxed in the hands of the Canadian "owners" as earned even though in the legal or accounting sense the income belongs to a controlled foreign corporation. It has not yet been made clear what kinds of income will be foreign accrual income, but reference is made in the White Paper to "dividends, interest, royalties and trans-shipment profits." We are told the legislation will be patterned generally on provisions of U.S.A. law. 139. The White Paper offers no data as to the magnitude of tax avoidance involved nor does it identify the numbers and types of avoidances so that it is difficult for the Association to assess both the problem and the proposed solution." 140. In 1962, the United States Congress enacted Sub-Part F of the Internal Revenue Code which deemed passive or "tainted" income to be immediately taxable in the hands of a U.S.A. parent as a phantom dividend. There were many complex rules and many escape or safe havens to meet objections raised by legitimate enterprise. But the purpose was reasonably clear. One clear motive was to force repatriation of earnings for balance of payments reasons. Also, under U.S.A. law, dividends received by corporation were taxed with allowance for foreign tax credits. Congress felt that deferring tax was akin to avoiding tax, particularly where the money was reinvested abroad. So, again, they wished to force repatriation. 141. The balance of payments motive is not relevant in Canada's case. Likewise, tax avoidance by corporations is not an issue in the cases where dividends from controlled foreign corporations are now and will be tax-exempt. Their retained earnings are generally reinvested in plant or repatriated to Canada since there is no tax reason not to repatriate to Canada.

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: International Income
Passive Income (Cont'd)

Present Tax Law	White Paper Proposals	Principal Points of Brief
		142. We can only assume that the tax avoidance complained of concerns private individuals who transfer assets to controlled corporations or trusts in low tax jurisdictions to avoid Canadian tax on the earnings (interest, dividends, etc.). We do not believe that Canadian widely-held corporations are or ought to be the target of this legislation, We believe they should be clearly exempted for the foregoing plus the following reasons: (i) Such tax avoidance as may be attempted by these companies can be effectively policed by existing law dealing with pricing (Section 17), interest (Section 19), and those provisions dealing with artificial transactions generally. (ii) Widely-held companies cannot effectively take personal income and estate tax motivation of individual shareholders into account in their foreign investment policies. They are subject to public disclosure. (iii) The necessary complexity of this type of law will of necessity have a negative impact on export efforts and on the competitive position of Canadians in international commerce. (iv) If there is uncertainty about the tax avoiding behaviour of large corporations in this area, it would seem wiser to introduce a five-year period of reporting of critical information around which convincing revenue protecting rules could be built.

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: International Income Withholding Taxes

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 26 to 30 of the Brief WITHHOLDING TAXES 144. We recognize the motive in Canada increasing its withholding tax rates to achieve a basis for negotiation with other countries. However, in the long run, such action can only hinder the real mobility of capital. We favour, generally, the OECD principle that by bilateral agreement a ceiling rate of ten per cent is appropriate in respect of interest and a five per cent rate in respect of dividends paid by a controlled corporation to its non-resident parent.

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: International Income
Capital Gains

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 26 to 30 of the Brief CAPITAL GAINS 145. A full rate of tax on gains realized on the sale of shares in a controlled foreign corporation is wrong in principle since it contemplates taxation of purely inflation gain and undistributed income which (presumably) would have been exempt if remitted as dividends. Frequently, dividends are restricted by local law to a percentage of registered capital (as in Norway and Brazil). Thus, the surplus account is not at the free disposition of the Canadian parent. It is possible that such rules (or total restraint or repatriation for exchange control reasons) will cause the Canadian parent to sell some part or all of its interests. 146. Broad roll-over provisions are required to facilitate foreign corporate re-organizations (even where an element of barter is involved i.e. where a larger interest in corporation A is surrendered for a smaller interest in amalgamated corporation AB) because there will be no economic gain nor any opportunity for tax avoidance as may be thought in the Canadian context and thus no policy need to impose tax except on genuine realizations. 147. Another critical problem concerns tax treatment to be applied to expropriations on forced sales. Canadian companies have major interests in less developed countries. Recent developments in some countries indicate the possibility of situations wherein the Canadian parent would be forced to sell some part or all of its interests in large going concerns to the host governments. 148. Taxation by Canada of capital gains realized or deemed realized by non-residents on Canadian shares would be contrary to internationally recognized taxation principles and would seriously affect Canada's ability to negotiate tax treaties. It would discriminate against the non-resident shareholder who would not have the offsetting reduction of Canadian tax through deductibility of capital losses. It

Name: **THE CANADIAN MANUFACTURERS' ASSOCIATION**

Principal Subject: International Income
Capital Gains (Cont'd)

Present Tax Law	White Paper Proposals	Principal Points of Brief
		would also be a strong deterrent against foreign equity investment in Canada. In view of almost certain retaliation by other countries, consideration should also be given to the reverse side of the proposal: Canada would have to allow full credit for foreign capital gains tax paid by Canadian residents on gains on foreign shares. 149. The proposed measure raises practical and administrative complexities not justified by its intended effect.

Name: THE CANADIAN MANUFACTURERS' ASSOCIATION

Principal Subject: International Income
Foreign Tax Credits

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 26 to 30 of the Brief FOREIGN TAX CREDIT 150. The proposal to restrict the foreign tax credit on investment income to 15 per cent is a further discrimination against foreign investment. Many countries impose withholding tax in excess of 15 per cent on dividends and in view of the reduced treaty bargaining position of Canada that would result from the White Paper proposals, it is by no means certain that Canada would obtain a 15 per cent maximum on withholding taxes on dividends in its future treaties. This proposal requires careful re-examination.

APPENDIX "C"

Submission by

BELL CANADA

on

PROPOSALS FOR TAX REFORM

made by

THE HONORABLE E. J. BENSON

MINISTER OF FINANCE

April 1970

PROPOSALS FOR TAX REFORM MADE BY THE HONORABLE E.J. BENSON MINISTER OF FINANCE

A SUBMISSION BY BELL CANADA

Summary

As a major taxpayer and as a public utility playing an important role in the Canadian economy, Bell Canada is vitally interested in the proposals for tax reform.

The Company offers the following general comments on the impact of the proposals on the economy:-

1. The goal of equity appears to have been stressed at the expense of economic growth and incentives for higher productivity.
2. Implementation of the proposals will tend to inhibit corporate saving and probably personal saving. This will have an inflationary effect.
3. The higher revenues to be collected by the government will tend to reinforce the inflationary effect.
4. The proposal to integrate personal and corporate taxes will tend to make equity investment more attractive and debt less so. As a result, bond interest rates will be higher than they would otherwise be.

As a regulated public utility Bell Canada is seriously affected by these tendencies.

To alleviate the scarcity of Canadian debt capital that would result from the integration proposal, it is suggested that the withholding tax on bond interest payments to non-residents should be eliminated. This would facilitate the issue of debt in foreign capital markets.

The Company offers the following comments on specific proposals in the White Paper:-

1. Bell Canada in principle favours full integration of personal and corporate taxes in all cases. Partial integration as proposed should be regarded as an initial step towards the objective of full integration.

   The gross-up and credit for corporate tax conflicts with other government objectives for which special tax incentives are offered, e.g., capital cost allowances, scientific research. A modification is suggested which would reconcile this conflict.

2. Bell Canada agrees that short-term speculative gains should be treated as income and taxed at the full rate. However, it is of the opinion that long-term capital gains should be taxed at a substantially lower rate. Deemed realization, for shares of widely-held companies and for all assets when leaving Canada, can create hardship and should not be adopted.

3. The present lower rate of tax on the first $35,000 of taxable income provides an important source of capital for many small companies. A suggestion is offered for continuing this feature while preventing some of the abuse to which it is subject.

4. The proposal not to permit gross-up and credit for corporate tax in the case of electric, gas and steam utilities is discriminatory and could result in higher costs and restrict expansion and modernization.

5. The proposal to disallow deduction of all convention, entertainment and similar expenditures is too broad and would penalize legitimate and necessary business expenses, many of them of an educational nature.

6. The proposed limitation on foreign investments of registered pension plans would restrict the application of sound investment principles in diversifying and in maximizing earnings.

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PROPOSALS FOR TAX REFORM MADE BY THE HONORABLE E.J. BENSON MINISTER OF FINANCE

A SUBMISSION BY BELL CANADA

1. INTRODUCTION

Bell Canada is the largest telecommunications company in Canada, and one of the country's largest corporations. Of more than 250,000 shareholders, 98% are resident in Canada. In addition to providing various communications services to over 3.5 million customers in Ontario Quebec, Labrador and parts of the Northwest Territories, Bell has complete or majority ownership of other telephone and telegraph companies which provide services in the Maritime Provinces, Newfoundland, and areas of Quebec and Ontario. As a member of the Trans-Canada Telephone System, Bell also plays a major role in the planning and operation of Canada's vital coast-to-coast telecommunications network. Northern Electric Company Limited is a wholly-owned subsidiary of Bell Canada, and in addition to being one of Canada's major manufacturers of communications equipment for both domestic and overseas markets, carries out a large and important segment of the nation's scientific research and development activities.

In 1969 Bell Canada's total taxes amounted to $183,500,000, of which $103,800,000 represented income taxes, $80,500,000 federal and $23,300,000 provincial. These taxes constitute costs of doing business and must be borne by the Company's 3.5 million customers. In total they were equivalent to almost $33 per telephone in service or $5.16 per share of Bell's capital stock.

In addition, in 1969 Bell Canada collected $44,600,000 in sales and telephone taxes from our customers. Added to the amount mentioned

in the preceding paragraph, this results in total taxes of over $40 per telephone in service.

As one of the largest taxpayers in Canada, and playing a major role in the country's economy, Bell is deeply concerned with both the basis and extent of taxation and has a vital interest in proposals for tax reform.

The government's White Paper deals only with income tax reform at the federal level. Amongst the unknowns in the proposals for reform are the attitudes of the Provincial tax authorities as to both tax practices and rates, the Federal authority's intentions with respect to other forms of levy such as sales tax, and its intentions with respect to capital cost allowances, a significant factor in income tax determination.

Until these matters are clarified, opinions on the proposed reform measures can only be formed with reserve. However the public's views have been invited, and subject to the reservations mentioned, Bell Canada's comments are offered in the pages which follow.

2. GENERAL COMMENTS

While more detailed comment will be made on specific proposals contained in the White Paper which affect the Company and its telephone subsidiaries directly, some general comments on the possible economic consequences of the proposals would seem to be in order.

These comments are offered in the light of the basic aims of the government's proposals as stated in paragraph 1.6 of the Paper. These are, to quote:

> "A number of goals and standards have guided the government in its approach to reform. They include a fair distribution of the tax burden based upon ability to pay; steady economic growth and continuing prosperity; the recognition of modern social needs; widespread understanding of and voluntary compliance with tax laws,

combined with enough detail to block loopholes; and, finally, a system that can and will be used by the provinces as well as Canada."

Some of the goals included in this statement are conflicting. The view has been expressed in many quarters that the proposals designed to accomplish the "equity" objectives included in these aims have been made at the expense of those concerned with economic growth and the motivation of improved performance. With this view we tend to agree. We doubt that a proper balance has been struck.

Of greatest concern to us are:

1. The inhibiting effect of the proposals on both personal and corporate saving.

2. The probable impact on the capital markets for equity and debt securities, both domestic and foreign.

3. The inflationary implications of the proposals.

4. The resulting impact on economic growth.

There appears to be fairly general agreement that implementation of the government's proposals will have an inhibiting effect on both corporate and personal savings, with resulting additional pressures on the capital markets for the funds with which to finance expansion.

Corporate saving will be inhibited by the encouragement to higher dividend payout inherent in the proposal for integration of corporate and personal income taxes, by the removal of the low rate of corporate tax on the first $35,000 of taxable income, and by the taxation of corporate capital gains.

The net effect of the proposals on personal savings is not clear. However, we do know that as personal incomes rise over time more taxpayers will enter the income brackets where the proposed tax rates will be higher than under the present system. This will tend to reduce the proportion of personal incomes saved, and at the same time increase the proportion of personal incomes paid in taxes. These effects grow as

the rates of tax become more steeply progressive. It is also apparent that the relief offered to lower income taxpayers will be inflationary in its effect in that most of the increases in disposable income will be consumed rather than saved.

The White Paper forecasts a significant increase in total tax revenues after five years. This represents government appropriation of a larger share of the national product at the expense of corporate and personal savings. The inflationary effect of the proposals will be accentuated if the government uses the additional revenues to embark on new expenditure programs.

The direct effects of the proposals relating to the mining and petroleum industries can best be evaluated and commented on by those concerned. However, it seems probable that if they are implemented they will have the effect of discouraging economic growth generally.

The Minister of Finance has stated in the House of Commons that criticism of the White Paper on the grounds that it is most inappropriate during a period of severe inflation is unwarranted, as the government expects that inflation will be contained by the earliest date of implementation. Bell Canada feels that, regardless of the state of the economy when these proposals are implemented, it is unwise for the nation to commit itself in advance to a taxation system which is recognized as inflationary and could well inhibit economic growth.

The integration of personal and corporate income taxes to the benefit of residents of Canada is expected to encourage Canadian ownership of Canadian business. While this is a constructive measure and a logical extension of the present dividend credit, it is likely that a shift from bonds to equities by Canadian investors can be expected, which will lower bond prices and increase the cost of borrowing in Canada. Whether non-resident investors will provide enough additional investment in debt securities to offset such an increase in interest rates is open to question.

In summary, Bell Canada's attitute to the White Paper proposals, from an economic viewpoint, can be stated simply: All taxes are ultimately paid by individuals, and significantly, the largest revenue shifts estimated by the Department of Finance,without any provision for growth, are the gain of $1,255 millions resulting from the proposed rate schedules, offsetting the loss of $1,000 millions due to increasing personal exemptions, a measure designed to help low-income taxpayers. Insofar as these changes, coupled with the proposed capital gains tax and other measures, act against savings and investment and contribute to inflation this goal will not be reached. The underprivileged in Canada require the job opportunities which can best be provided by private investment, and maintenance of the purchasing power of their earnings. Only if these objectives are attained can other governmental policies add to the well-being of these Canadians.

3. HOW THE IMPACT ON THE ECONOMY AFFECTS BELL CANADA

Bell Canada, as a regulated public utility, is particularly sensitive to the effects of inflation. Inflation,be it demand - induced or cost - push, will cause companies which supply materials and services to raise their prices, thus increasing the operating costs of the utility. Bell Canada as a regulated enterprise can only adjust prices by applying to the authorities for rate relief. Based on past experience, even if such a request is well-founded, a substantial time period elapses before increased rates are approved. During this period of lag,with inadequate earnings, the Company is disadvantaged in the capital market. The tax proposals favour equity investments but funds will not be attracted to stocks with poor earnings prospects, i.e., the stocks of regulated enterprises in an inflationary period.

Under the Company's charter Bell Canada does not have the freedom enjoyed by most enterprises to limit its activities to those which are, or are expected to be, most profitable. The obligation to provide basic telephone services on demand commits the Company to a program of expansion

and modernization. The Company's equipment and network facilities must be expanded and kept up to date as the population increases and the economy expands, despite the difficulties which may be faced in financing such expansion. It is therefore essential to the maintenance of an efficient Canadian telecommunications net work that Bell Canada be able to raise capital at all times on reasonable terms.

As an indication of the volume of external financing involved, Bell alone has raised a total of $1,491 millions during the ten years 1960 to 1969. Of this total, $576 million was obtained through common stock issues in Canada and $915 million through issues of bonds, $375 million of the latter amount having been raised in the United States.

The effects of taxation on the capital markets are therefore of vital importance to Bell Canada and to its associated companies. The benefits to Canadian business which are expected to accrue from the proposals for the integration of corporate and personal income taxes will no doubt be positive on the equity side, but it seems more than likely that they will be negative on the debt side. The significantly increased tax advantage attaching to equity investments will undoubtedly diminish the supply of money available in the domestic bond market. This effect on the capital markets could have serious consequences for corporate as well as governmental borrowers. At the very least it will mean debt costs higher than would otherwise apply.

To alleviate the scarcity of Canadian debt money, and the consequently higher interest rates, Bell Canada recommends that the government reconsider its policy on the non-resident withholding tax as it applies to interest payments. The White Paper proposal is to increase the statutory withholding rate to 25%, while retaining a 15% rate limitation where a reciprocal tax treaty is in effect or can be negotiated. For interest payments to foreign lenders we recommend the elimination of withholding tax completely.

Despite the tightness of both the Canadian and United States bond markets on which Bell Canada has traditionally depended for debt capital, we have been deterred from obtaining foreign capital because of the incidence of the existing withholding tax which substantially increases the cost of such borrowing. With the anticipated reduction in the availability of debt money in the domestic market, should the integration proposals be adopted, it is important that the capital intensive utilities, as well as other corporate borrowers, have ready access to both United States and overseas sources on the most reasonable terms possible. This can be an important contribution towards lessening the need for increased rates for Canadian consumers. The net reduction in government revenues would not, we believe, be significant, and the suggestion would be consistent with the declared national policy of encouraging debt rather than equity foreign investment.

4. SOME SUGGESTED MODIFICATIONS TO THE PROPOSALS RE INTEGRATION

There can be no doubt that the basic proposals for the integration of personal and corporate income taxes are among the most progressive and economically stimulating in the entire White Paper. There are, however, certain illogicalities in the scheme put forward by the government, and a large number of technical problems which remain unresolved.

Bell Canada favours in principle full integration of corporate and personal income taxes with no distinction as between closely-held and widely-held companies. However, we recognize that the government may not be able immediately to absorb the loss in tax revenues implicit in such a system. If this is so, partial integration for widely-held corporations should be regarded merely as a first step, with a plan for full integration clearly established according to a schedule.

A significant problem area which Bell Canada has identified in the integration proposal is that in which the benefits accruing to shareholders

from the gross-up and credit procedure may be reduced because of tax incentives granted to corporations by the government. Although the present combined federal and provincial corporation tax rate exceeds 50% in every province, many corporations do not currently pay taxes amounting to this proportion of the income as recorded in their corporate accounts in accordance with accepted business practice. This is because the Income Tax Act permits deductions in computing taxable income of capital cost allowances, depletion allowances and mineral exploration and scientific research expenditures which reduce the amount of tax currently paid by many corporations.

As the government proposes that tax credits will flow to shareholders only for corporation taxes currently paid, the situation will exist in many cases where the reported net incomes are not fully tax-paid. If these corporations pay out most of their income as dividends, their shareholders will pay tax at their individual marginal rates, with no corporate tax credit for a portion of their dividend income. In effect the shareholders of a widely-held corporation will pay to the government between 25% and 50% of the taxes not immediately paid by the corporation because of taking advantage of tax incentive allowances.

The situation as it could affect Bell Canada shareholders is illustrated in Attachment 1. In brief, the taxes paid concept in the application of the dividend gross-up proposal is in conflict with the government's program of granting tax incentives. One effectively negates the other.

However, if it is the government's intention to retain in the Income Tax Act the incentive deductions now permitted - and one must assume that it is since the White Paper gives no indication to the contrary - it does not appear logical to recover from shareholders some or all of the taxes deferred as a result of considered government policy.

Bell Canada suggests that consideration be given to eliminating this weakness in the integration proposal by the modifications outlined below.

When a corporation distributes to its shareholders earnings on which tax has not been paid because of specified business incentive deductions, such as capital cost allowances in excess of recorded depreciation, or capital expenditures related to scientific research and development, for the purpose of shareholders' tax credits tax will be deemed to have been paid on this distribution. To prevent the same amounts being credited to shareholders at a future date when the corporation actually pays the taxes previously deferred, shareholders will be required to reduce the cost or valuation basis of their shares by the amount of dividends on which tax was deemed to have been paid. These shareholders will thus be required at some future date, when disposing of the shares or when revaluing them for tax purposes, to pay capital gains tax on these amounts. The application of this suggestion is illustrated in Attachment 2.

The government also proposes that the existing tax-free status of dividends passing between taxable Canadian corporations be abolished, and that credit be given to corporate shareholders only for taxes actually paid by the corporation making the distribution. One of the reasons advanced in support of this change is that under the present system it is possible for the bulk of the income of a Canadian corporation to consist of exempt dividends from certain foreign corporations and "foreign business corporations", so that little or no Canadian tax has been paid on the income from which dividends paid to Canadian residents qualify for the dividend tax credit.

Bell Canada agrees that the Canadian Treasury should not suffer a revenue loss in this manner, but suggests that the proposed solution is too sweeping, in that it again will operate against tax incentive allowances. Where, for example, Northern Electric Company Limited, a wholly-owned subsidiary, pays dividends to Bell out of income on which tax has not been paid because of the deduction of capital expenditures in respect of scientific research and development, Bell will be required, under the proposal, to pay corporate tax at a rate of 50% on the dividend income received, which is free of tax under the present system.

Bell Canada's suggestion for providing for "deemed tax paid" credits would alleviate this problem without incurring any government loss of revenue, in that corporate tax would be deemed to have been paid only where the dividend-paying corporation had reduced its tax payments by virtue of specified incentive tax deductions. Foreign-source income would not qualify for this treatment, so that this revenue problem identified by the government would be resolved.

Another problem presents itself under the proposed procedure for calculating dividend gross-up. Officials of the Department of Finance have indicated that the amounts of creditable tax available for a corporation to "distribute" with its dividends will be based on the instalment payments of tax already made in the year. This actually gives rise to two technical problems. Firstly, since instalment payments are almost invariably based on the previous year's tax liability, which is normally lower than that of the current year, shareholder tax credits will tend to be continuously deferred. The second problem can be illustrated from Bell Canada's dividend practice, where a dividend has traditionally been declared late in the year and paid in January of the following year. As the Company will have made no instalment payments of tax for the current year in January of 1971 (or whichever year the proposals are implemented) any dividend paid in that month will not be eligible for a tax credit in the shareholder's hands. It is suggested that the government give consideration to creating special transitional provisions for dividends paid by corporations during the first year.

The White Paper indicates that the gross-up and credit feature will not apply in the case of shareholders who are non-residents or who are tax-exempt, e.g., pension funds. It does not explain, in a case where the creditable tax is less than the dividend paid, whether the tax available is to be allocated pro rata to all shareholders or assigned entirely to only those shareholders who are eligible for the gross-up and credit.

5. CAPITAL GAINS

Bell Canada cannot argue against the imposition of a tax on capital gains on the grounds of equity. It would appear appropriate to treat short-term speculative gains as income and tax them at the full rate. However, it must be realized that similar treatment of long-term gains will lessen the attraction of equity investment, counteracting to some extent the positive gains expected from integration. If Canada is to attract the large amounts of capital needed to sustain growth of the economy, long-term capital gains should be taxed at a rate substantially lower than that for ordinary income.

Increases in the dollar values of many assets over time is to some extent a result of a decrease in the value of the dollar, and to that extent is not the result of an increase in the real value of the asset. The taxation of long-term gains at less than full rates would avoid the inequity of taxing these illusory gains arising from inflation.

The proposal that shareholders of widely-held corporations be required to pay tax on accrued capital gains every five years discriminates against holders of these assets in relation to holders of all other forms of property.

The accrued gains proposal will also cause hardship where a shareholder would have to liquidate part of his investment in order to pay the tax. While the White Paper argues that this will increase the efficiency of the capital markets by avoiding a "lock-in" influence on investors, it will also remove funds from the market and reduce the amount of capital available for private investment. It should also be noted that shareholders who have small cash incomes will be those most likely to be forced to sell shares to meet their tax liabilities, and that these are the people who will be least able to benefit from the deductibility of accrued losses should the market value of their holdings decrease at a later date.

The estimated revenue from this proposal is $100 millions in the fifth year after implementation. This is a substantial sum, but less than

1% of the total federal and provincial income tax yield. Bell Canada therefore suggests that consideration be given to withdrawing this proposal.

The government proposes that a taxpayer giving up residence in Canada be treated as though he had sold all his assets at fair market value and pay tax on any resulting capital gains. This proposal will inflict a hardship on individuals who give up Canadian residence temporarily to further their education abroad, and on employees who are assigned to overseas projects or training courses by their employer. This application will also impose hardship in the case of older persons who for health reasons seek a warmer climate in which to spend their retirement years.

In summary, Bell Canada strongly recommends that the government aim for full integration of corporate and personal income taxes, that creditable tax be extended to include tax deferrals on account of government incentive programs, and that long-term capital gains not be subject to tax at full income tax rates, and that the deemed realization of capital gains be abandoned.

6. OTHER PROPOSALS OF CONCERN TO BELL CANADA

a) Unanswered Tax Questions

A major concern is that certain important fields of taxation are not covered by the proposals. Earlier in this presentation we commented on the fact that the government's intentions in regard to capital cost allowances are not included in the White Paper.

There have been indications from time to time that modifications to the capital cost provisions of the Income Tax Act or even their abandonment may be under consideration. Before

proper assessment of the tax reform proposals can be made, doubts and uncertainties in this regard should be removed.

Insofar as they apply to the investment in telephone property, the present rates of capital cost allowances are clearly inadequate. They do not provide for the amortization of capital cost over its useful service life, a fact of growing concern in view of the rapidity of technological development in the communications field.

We urge that proposals with respect to capital cost allowance be published and exposed to discussion at the earliest possible date and before the White Paper proposals are proceeded with.

b) Low Rate of Tax For Small Corporations

The proposal for the abolition of the low 21% rate of tax on the first $35,000 of taxable income has no significant direct effect on large corporations like Bell Canada. However, Bell does feel that consideration should be given to the useful part played in capital formation by the corporate retentions resulting from this low rate of tax. The next decade is generally regarded as one in which capital will be scarce, and it can be expected that small and new firms will suffer most from this scarcity.

It is therefore suggested that a low rate of corporate tax, say 25%, be retained for an initial amount of corporate income, say $25,000, but that its application be limited to a maximum cumulative amount of income of $125,000. By this method a corporation which earned $125,000 in the first year of implementation will thereafter pay tax at the full rate on its entire taxable income, as will any other corporation in a year in which its total taxable income since implementation exceeded the maximum. The proposals re integration, coupled

with the proposed capital gains tax, should be adequate to protect the public treasury from losses caused by converting non-fully taxed corporate income to personal income without the payment of additional tax.

c) Electric, Gas and Steam Utilities

The proposal that the federal government will not extend tax credits to shareholders of electric, gas and steam utilities for corporate tax paid by their corporations where the taxes are turned over to the provinces is a logical one within the framework of the integration proposals. However, unless the provinces agree to grant Canadian resident shareholders credit for both federal and provincial corporate taxes paid by these corporations, individual shareholders will be discriminated against in receiving a lower after-tax return on such investments compared with the present system and under the proposals, with shareholders in other companies. In such a situation it can be expected that share prices of these utilities will fall. The raising of equity capital will become difficult for these utilities, which might force them into overdependence on the bond market. This could lead to imprudent capital structures, loss of credit, and higher costs and to restriction of the modernization and expansion of equipment. In any case it would have a harmful effect on the customers. This would be much more widespread if the present treatment of electric, gas and steam utilities were extended to telephone companies.

d) Business Expenses

A minority of taxpayers may be abusing the present business expense deduction provisions of the Income Tax Act, and this should be eliminated. However, in proposing that all convention, entertainment and club membership expenditures should be non-deductible, the government is virtually stating that these

are not real business expenses in the course of earning income. Many conventions and seminars are educational in nature and attendance is essential to keep up-to-date with new developments. For Bell Canada at least, expenses are closely scrutinized by senior management, and are subject to audit. They must also be justified during regulatory review. It is therefore proposed that arbitrary disallowance of these types of business expenditures is undesirable and unnecessary, and that stronger enforcement of the present law should be applied to check abuses.

e) Limitation on Foreign Investments of Pension Plans

The White Paper proposes to limit the investment of a registered pension plan in foreign securities to 10% of the total assets of the plan.

Investment in foreign securities is desirable in order to allow participation in industries not represented in Canada, to increase liquidity in the fund by allowing investment in broader international markets, and to provide greater opportunity for increased capital gain and income. The proposal will limit the scope for such diversification and the opportunity for maximizing earnings in accordance with sound investment principles. The restriction of investment opportunity will tend to increase the cost of maintaining such funds, or will tend to decrease the pension benefits which may be provided.

f) Business and Property Income

Bell welcomes the proposal for the deductibility via amortization of business "nothings" as an important improvement in the taxation of business income.

7. ADMINISTRATIVE IMPLICATIONS

Bell Canada employs in excess of 38,000 people, and has over a quarter of a million shareholders. Under the present system, the Company devotes a considerable amount of effort to reporting tax information to employees and shareholders and withholding and remitting income tax on their behalf. Any increase in administrative procedures in our dealings with these groups will be of significance in terms of costs incurred and in employee and shareholder relations.

In large corporations much of the administrative work is and will be carried out by computers, resulting in a reduction of time and effort required. However, programming requires considerable lead time. Consideration should therefore be given to always allowing sufficient time between the adoption of legislation and its implementation.

8. CONCLUSION

This submission represents an attempt by a large taxpayer which is also a regulated public utility to put forward its comments on the government's proposals in a constructive framework. Many of the criticisms advanced and the technical problems outlined will already have been brought to the attention of the responsible officials, and some of the proposals are already being re-examined by the Minister of Finance. It is hoped that participation in the debate by Bell Canada and its associated companies will play a part in improving Canada's tax system.

Attachment 1

BELL CANADA

PROPOSALS FOR TAX REFORM
ILLUSTRATION OF THE EFFECT ON SHAREHOLDERS OF CLAIMING
MAXIMUM CAPITAL COST ALLOWANCES IN EXCESS OF RECORDED DEPRECIATION
UNDER THE WHITE PAPER PROPOSALS

I COMPANY DATA

	Claiming Straight Line Depreciation	Claiming Maximum Capital Cost Allowances
Income before taxes	$200	$200
Less: C.C.A. in excess of recorded depreciation	0	60
Income subject to tax	$200	$140
Income taxes paid	$100	$ 70
Income taxes deferred (increase in cash flow)	$ 0	$ 30
Dividends paid	$100	$100
Creditable tax (50% of taxes paid)	$ 50	$ 35

II SHAREHOLDER DATA

	Marginal Rate of the Taxpayer		
Where Company Claims Straight Line	0%	20%	50%
Dividend received	$100	$100	$100
Plus taxable credit	50	50	50
Taxable amount	150	150	150
Gross Tax	0	30	75
Less credit	50	50	50
Net tax (refund)	$(50)	$(20)	$ 25
Where company claims C.C.A.			
Dividend received	$100	$100	$100
Plus taxable credit	35	35	35
Taxable amount	135	135	135
Gross Tax	0	27	67.5
Less credit	35	35	35.0
Net tax (refund)	$(35)	$(8)	$ 32.5
Difference - (in dollars)	$ 15	$ 12	$ 7.5
(as per cent of deferred corporate tax)	50%	40%	25%

Attachment 2

BELL CANADA

PROPOSALS FOR TAX REFORM
ILLUSTRATION OF THE EFFECT ON SHAREHOLDERS
OF A WIDELY HELD COMPANY OF SUGGESTED
MODIFICATION OF PROPOSAL RE INTEGRATION

I COMPANY DATA	White Paper Proposal	Bell Canada Suggestion
Income before taxes	$200	$200
Less: C.C.A. in excess of recorded depreciation	60	60
Income subject to tax	$140	$140
Income taxes paid	$ 70	$ 70
Income taxes deferred	$ 30	$ 30
Dividends paid	$100	$100
Creditable tax - taxes paid	$ 35	$ 35
- taxes deferred	-	$ 15

II SHAREHOLDER DATA	Marginal Rate of the Taxpayer		
	0%	20%	50%
White Paper Proposal			
Dividend received	$100	$100	$100
Plus creditable tax - taxes paid	35	35	35
Taxable amount	$135	$135	$135
Gross tax	0	27	67.5
Less credit	35	35	35.0
Net tax (refund)	$(35)	$ (8)	$ 32.5
Bell Canada Suggestion			
(a) Dividend related -			
Dividend received	$100	$100	$100
Plus creditable tax - taxes paid	35	35	35
- taxes deferred	15	15	15
Taxable amount	$150	$150	$150
Gross tax	0	30	75
Less credit	50	50	50
Net tax (refund)	$(50)	$(20)	$ 25
(b) Capital gains related -			
Reduction in share valuation	$ 30	$ 30	$ 30
Taxable gain - 50%	15	15	15
Tax on capital gain	$ 0	$ 3	$ 7.5
(c) Total net tax (refund)	$(50)	$(17)	$ 32.5

APPENDIX "D"

NAME: BELL CANADA

SUBJECT: White Paper Proposals.

Analysis of Appendix "C" by Senior Advisor

This brief is submitted by Bell Canada, a corporation with more than 250,000 shareholders, of whom 98% are resident in Canada. The company offers its services to some 3.5 million customers.

The brief deals with the following proposals:

1. Capital gains.
   (Pages 11 and 12 of the brief)
2. Capital cost allowance.
   (Pages 12 and 13 of the brief)
3. Low rate of tax for small corporations.
   (Pages 13 and 14 of the brief)
4. Business expenses
   (Pages 14 and 15 of the brief)

In addition the brief deals in general terms with other proposals in so far as they affect the general economy and thus are indirectly of concern to the company.

The brief makes a number of recommendations and suggestions as follows:

1. "To alleviate the scarcity of Canadian debt money, and the consequently higher interest rates, Bell Canada recommends that the government reconsider its policy on the non-resident withholding tax as it applies to interest payments. The White Paper proposal is to increase the statutory withholding

rate to 25%, while retaining a 15% rate limitation where a reciprocal tax treaty is in effect or can be negotiated. For interest payments to foreign lenders we recommend the elimination of withholding tax completely."
(Page 6 of the brief).

2. If Canada is to attract the large amounts of capital needed to sustain growth of the economy, long term capital gains should be taxed at a rate substantially lower than that for ordinary income.
(Page 11 of the brief).

3. The estimated revenue from this proposal (five year revaluation) is $100 millions in the fifth year after implementation. This is a substantial sum, but less than 1% of the total federal and provincial income tax yield. Bell Canada therefore suggests that consideration be given to withdrawing this proposal.
(Pages 11 and 12 of the brief).

4. "We urge that proposals with respect to capital cost allowance be published and exposed to discussion at the earliest possible date and before the White Paper proposals are proceeded with."
(Page 13 of the brief).

5. "It is therefore suggested that a low rate of corporate tax, say 25%, be retained for an initial amount of corporate income, say $25,000, but that its application be limited to a maximum cumulative amount of income of $125,000. By this method a corporation which earned $125,000 in the first year of implementation will thereafter pay tax at the full rate on its entire taxable income, as will any other corporation in a year in which its total taxable income since implementation exceeded the maximum. The proposals re integration, coupled with the proposed capital gains tax, should be adequate to protect the public treasury from losses caused by converting non-fully taxed corporate income to personal income without the payment of additional

tax."
(Pages 13 and 14 of the brief).

6. "A minority of taxpayers may be abusing the present business expense deduction provisions of the Income Tax Act, and this should be eliminated. However, in proposing that all convention, entertainment and club membership expenditures should be non-deductible, the government is virtually stating that these are not real business expenses in the course of earning income. Many conventions and seminars are educational in nature and attendance is essential to keep up-to-date with new developments. For Bell Canada at least, expenses are closely scrutinized by senior management, and are subject to audit. They must also be justified during regulatory review. It is therefore proposed that arbitrary disallowance of these types of business expenditures is undesirable and unnecessary, and that stronger enforcement of the present law should be applied to check abuses."
(Pages 14 and 15 of the brief).

The brief on page 14 comments upon effect of the proposals upon electric, gas and steam utilities and expresses the concern that it might have an adverse effect upon telephone companies.

On page 15 of the brief it is pointed out that the proposal to limit the foreign investments of pension plans will tend to increase the cost of maintaining such funds, or will tend to decrease the pension benefits which may be provided.

The brief concludes with remarks upon the administrative implications of the White Paper proposals and points out that any increase in this area will be of significance in terms of costs incurred and in employee and shareholder

relations.

The attention of the Committee is drawn to the following comments:

1. "As the government proposes that tax credits will flow to shareholders only for corporation taxes currently paid, the situation will exist in many cases where the reported net incomes are not fully tax-paid. If these corporations pay out most of their income as dividends, their shareholders will pay tax at their individual marginal rates, with no corporate tax credit for a portion of their dividend income. In effect the shareholders of a widely-held corporation will pay to the government between 25% and 50% of the taxes not immediately paid by the corporation because of taking advantage of tax incentive allowances.

   The situation as it could affect Bell Canada shareholders is illustated in Attachment 1. In brief, the taxes paid concept in the application of the dividend gross-up proposal is in conflict with the government's program of granting tax incentives. One effectively negates the other.

   However, if it is the government's intention to retain in the Income Tax Act the incentive deductions now permitted - and one must assume that it is since the White Paper gives no indication to the contrary - it does not appear logical to recover from shareholders some or all of the taxes deferred as a result of considered government policy."
   (Page 8 of the brief).

2. "The White Paper indicates that the gross-up and credit feature will apply in the case of shareholders who are non-residents or who are tax-exempt, e.g., pension funds. It does not explain, in a case where the creditable tax is less than the dividend paid, whether the tax available is

to be allocated pro rata to all shareholders or assigned entirely to only those shareholders who are eligible for the gross-up and credit."
(Page 10 of the brief).

3. "The proposal that shareholders of widely-held corporations be required to pay tax on accrued capital gains every five years discriminates against holders of these assets in relation to holders of all other forms of property."
(Page 11 of the brief).

The brief does not lend itself to the preparation of the usual summary of present laws, White Paper proposals and principal points of the brief.

APPENDIX "E"

THE

CANADIAN CHEMICAL PRODUCERS' ASSOCIATION

COMMENTS ON

THE PROPOSALS FOR TAX REFORM

TABLE OF CONTENTS

INTRODUCTION

In submitting this paper The Canadian Chemical Producers' Association (CCPA) wishes to express its appreciation of this opportunity to comment upon the proposals for tax reform. We believe this to be a courageous innovation which can and should lead to increased dialogue and thereby improved understanding between Government and the people.

In preparing these views CCPA has sought to be dispassionate and objective. We desire to lay before Government our concerns and to outline the effects which we believe the proposals are likely to have upon the economy.

The reader may ask, "What and who are The Canadian Chemical Producers' Association?" To answer this question we have placed a brochure in an envelope on the inside of the front cover. The reader may also wish to know the nature and extent of our industry's contribution to the Canadian economy, therefore, we offer the following facts:

... the CCPA is comprised of 43 member companies with plants located from coast to coast. For names of member companies see the brochure;

... total assets in Canada approximate $2.5 billion;

... the Canadian chemical industry employs some 75,000 people with an annual payroll of some $475 million;

... the level of wages and salaries is almost 20% above the national average;

... value added per employee is over $16,000, the national average is $9,480;

... Canadian chemical industry output approximates 6% of all manufacturing and the value added by manufacture represents 7% of all manufacturing;

... federal income tax paid amounts to 8% of all manufacturing;

... in 1965 the industry ranked fourth among 20 leading industry groups in terms of total tax dollars paid to the Federal treasury;

... prices have risen only 7% in the last ten years.

The following are factors we believe merit particular consideration:

... taxation policy can only be accurately assessed when it is examined within the framework of our long-term national economic and fiscal objectives. The absence of such objectives makes rational and constructive criticism of the tax proposals difficult.

... the Canadian chemical industry can accurately be categorized as "high technology and capital intensive." Our study of the White Paper leads us to believe that inadequate attention has been focused upon industries such as ours. There is increasing evidence that Canada's future industrial and economic well-being is, to an important degree, dependent upon the manner in which such industries are developed. It is these industries which will enable Canada to derive maximum "value added" from our natural resources; and these industries which will provide challenging and rewarding employment for the scientists, engineers and technologists to whose education our country is properly devoting so much of its wealth.

... various statements in the White Paper imply that the high level of Canadian taxes is both justified and necessitated by public demand for more and more governmental services. While appreciating the political pressures, we believe the Government is elected to lead rather than to follow. Implicit in leadership responsibility is the need to decide upon priorities. We do not believe that any government can legislate prosperity; rather, we as a nation must earn it. This presupposes some economic laws and some economic constraints which must take precedence over public "demands" which, traditionally are unending.

... in 1965 Canada had a trade deficit in chemicals of $249 million, by 1967 this had risen to $309 million and the forecast suggests it will reach $500 million before 1975. In the fastest growing field - plastics - Canadian producers' domestic sales now account for only 59% of the Canadian market. The explanation for this rapid increase in imports is that Canada, unlike other industrial nations, exposes its domestic producers to intense competition from abroad.

... our study of the proposals leads us to suggest that insufficient attention has been given to the international aspects of life in our "global village". Canada, being largely dependent upon foreign trade, is in a vulnerable position. The rising trade imbalance in chemicals underscores the need to enhance our ability to compete for world markets and the essentiality of our tax and economic system being both competitive and compatible with that of our major trading partners.

... finally, we find ourselves gravely concerned about the world shortage of capital and Canada's ability to compete successfully in the increasingly intensive competitive environment brought about by international corporations. Estimates indicate it takes $15,000 to $20,000 in capital to provide the tools for each worker. If one but multiplies this by the numbers entering our Canadian work force each year, it provides a dramatic illustration of our near-future capital needs.

SUMMARY

The following is a synopsis of CCPA's detailed comments presented at Section "C".

PART 1

IMPACT ON ECONOMIC GROWTH AND PRODUCTIVITY

PRIORITY OF OBJECTIVES (Page C-1 to C-2)

A tax system that does not interfere seriously with economic growth and productivity is stated to be the second main objective of the proposed tax reform. The first objective, by inference, is fairness in taxation.

CCPA believes the first priority should be the creation of an economic environment that encourages saving, investment and risk taking thus continually adding to the economic base and the taxation base.

INCENTIVES AND ECONOMIC EFFECTS (Page C-2 to C-3)

CCPA agrees there is a continuing need to spur certain activities and that the tax system should be used in this way.

However CCPA questions if the proposals are in keeping with the stated policy when they result in: reduced national saving; a reduction in incentive by taxing capital gains at high rates; a dampening of investment enthusiasm by suggesting that capital cost allowances may be too high; continuation of high effective tax burdens on corporations relative to many countries; legislating Canadian business into a less competitive position in international markets by proposing to import United States law concerning foreign source income; and reduced incentive to reinvestment in small business.

HAZARDS OF MAJOR TAX REFORM (Page C-3)

Tax systems of most nations have evolved through many years and have been adjusted in response to prevailing conditions and the actions of other nations. Canada must be careful she is not introducing massive changes that put her out of step with the rest of the world in her ability to attract investment capital, help keep her business competitive in world markets and ensure growth of the Canadian economy.

CCPA suggests the government is asking the nation to take too great a risk with unknown consequences in seeking such a massive reform at one point in time.

COST OF RETENTION AND MOTIVATION OF KEY PERSONNEL (Page C-6)

People who will take risks, innovate and contribute are the key to economic progress. Canada desperately needs such people and it is important that these people are able to retain sufficient funds,

after taxes, to support their willingness to invest and innovate. The proposals shift a greater proportion of the tax burden to these middle income people thus reducing their effectiveness in the economy.

These people are already being overtaxed in Canada relative to their counterparts in the United States and now it is proposed to widen the gap. CCPA believes it would be unwise policy to reduce the incentive for this important segment of the population and to impair their capacity to invest.

The chemical industry has, by experience, found it highly desirable to transfer key scientific and managerial personnel across international boundaries for the maximum development of the individuals and the industry. The proposals will inhibit such international transfers to the detriment of Canadian industry.

PART 2

IMPACT ON INVESTMENT CAPITAL AVAILABILITY

DOMESTIC SAVINGS REDUCED (Page C-8)

The proposals result in an overall reduction of saving in Canada and thus a reduction in funds available for investment. Furthermore, this overall reduction is largely concentrated in the middle income group who are the people most likely to invest savings.

ATTRACTION OF FOREIGN CAPITAL (Page C-9)

Canada's past and continued dependence on foreign capital is recognized in the paper. However, the proposals result in a less attractive economic environment for foreign investment than is available to investors in many other countries, particularly the U.S.A.

CAPITAL COST ALLOWANCES (Page C-10 to C-12)

The White Paper suggestion that capital cost allowances may be too generous and will be reviewed later can only have an inhibiting effect on investment, particularly in capital intensive industries.

CCPA believes that capital costs are not dissimilar to current costs in the income generating process except for the timing of their absorption and that the taxpayer should be allowed much more flexibility in deciding when such costs are absorbed. This is a powerful tool to spur or inhibit investment. It is the belief of CCPA that government should use this tool to its maximum extent to encourage new investment in productive facilities and thus add to Canada's economic base.

PROPOSED CAPITAL GAINS TAX (Pages C-12 to C-13)

CCPA believes the relative immaturity of the Canadian economy compared to the United States suggests that the introduction of a full capital gains tax at this stage in our development is inappropriate.

CCPA believes it is fundamentally wrong to tax capital gains before they are realized and therefore opposes the proposed quinquennial evaluation procedures.

If Canada must have a capital gains tax CCPA suggests that it apply only to realized gains and at significantly lower rates separate from normal income and with an adjustment factor for inflation.

PART 3

IMPACT ON COMPETITIVE POSITION IN DOMESTIC AND WORLD MARKETS

CHEMICAL INDUSTRY ASPECTS (Page C-14)

A recently conducted study demonstrated that the chemical industry in Canada has special problems relating to scale and that high taxation is an important factor contributing to the poor competitive position of the Canadian chemical industry in world markets.

POTENTIAL IMPACT OF PROVINCIAL TAXES (Page C-14)

Business must be concerned with the total tax burden including federal, provincial and municipal taxes. These taxes must be coordinated so that the combined tax burden does not put Canadian business in an inferior competitive position in world markets.

EXTENT OF DIRECT TAXES ON CORPORATIONS (Pages C-14 to C-15)

CCPA believes other countries are using their tax systems to raise a greater proportion of their revenues from indirect taxes which qualify for exemption under the GATT rules. The White Paper proposals do not appear to recognize the need for Canada to use its tax system as a tool in international trade in response to the actions of other nations.

OVERREACTION TO ALLEGED ABUSES (Page C-16)

CCPA considers it fallacious to assume that all income must be taxed at Canadian rates when companies located in other countries, with whom we must compete, enjoy lower rates in their own jurisdiction or in other jurisdictions where they create marketing or licensing companies.

PART 4

OTHER AREAS OF CONCERN

COMPLEXITY (Page C-17)

CCPA suggests that implementation of the White Paper proposals will produce a complicated tax system which will result in admministrative costs out of proportion to the added revenue collected. This will discourage investors who may take their investment elsewhere.

INTEGRATION (Page C-17)

CCPA believes the proposal to integrate personal and corporate

taxation will result in conflicting pressures that will make it difficult for management to serve differing shareholder interests. We therefore believe that the integration proposals of the White Paper should not be adopted, particularly in view of the fact that these proposals represent a complete departure from the tax systems generally in use by other nations which tend to identify the corporation and the individual as separate taxable entities. Enlargement of the dividend tax credit system would appear to take care of the problem of incentive for investors and would minimize tax treaty negotiation problems.

COOPERATIVES (Page C-18)

CCPA believes that cooperatives, which are becoming large business enterprises, should be taxed on the same basis as other business enterprises.

EXPENSE ACCOUNT LIVING (Page C-18)

The CCPA agrees with the government's intention to eliminate abuses with respect to expense account living but suggests existing law provides all the authority required to prevent abuses. The CCPA does not agree with the proposals to disallow deduction of legitimate expenses necessary to earn income.

It is our belief that to achieve these goals Canada must create:

(a) A favourable investment climate - Canada requires a domestic investment climate which is more favourable than that of the United States and at least equal to that in other countries so that Canada may successfully compete in attracting industrial investment capital, of which there is a world-wide shortage;

(b) A tax system which encourages Canadian industry - Canada requires a taxation system which will assist Canadian industry to operate on a favourable basis with industry of other nations in the competitive environment of international markets.

(c) An economic environment attractive to skilled persons - Canada needs to attract such highly skilled persons as managers, craftsmen, technicians, scientists, investors, innovators; that is the type of people who contribute significantly to further social and economic development.

INCENTIVES

White Paper - Paragraph 1.11

"The government is aware of a continuing need to spur certain kinds of activities. -----Tax laws, however, have long been used to provide incentives to such ventures, and the government believes they should continue to be so used in a number of specific ways that are clearly understood and justified."

Comment

The CCPA fully supports this statement of government policy but questions if certain of the White Paper proposals are in keeping with this stated policy.

ECONOMIC EFFECTS

White Paper - Paragraph 8.35

"The tax reform proposals set forth in this paper are expected to have relatively modest impact upon the Canadian economy apart from the effects on savings in closely-held companies, and possibly on investment in the mining industry."

Comment

Despite the policy outlined in Paragraph 1.11 the government is proposing a major program for tax reform that is expected to have only "modest" effect on the economy. The "modestness" of the impact is, of course, a matter of conjecture. It is the CCPA's view that the tax system, as well as fiscal policy, should be structured to have a significant favourable impact on the economy.

HAZARDS OF MAJOR REVISIONS

In November 1967 the Honourable Mitchell Sharp, then Minister of Finance, in his Budget Speech made reference to the proposals of the Royal Commission on Taxation and indicated that he had been "particularly impressed" with:

"the sweeping extent of the changes recommended by the Commission and the difficulty of predicting the effects that sudden changes of this magnitude would have on the economy and ultimately on the position of various taxpayers".

The CCPA agrees with the principles underlying the statement by Mr. Sharp and believes them equally applicable to the current White Paper proposals.

We are aware of the Government's expression of concern in this regard which is outlined as follows:

White Paper - Paragraph 8.5

"The hazards of forecasting are increased when major changes are made in the tax structure. -----It is also necessary to

forecast the reaction of taxpayers when confronted with new opportunities or new limitations on their behaviour. These risks are particularly important in connection with the current program".

Comment

The CCPA agrees with this statement and suggests that the government should be extremely careful in introducing a massive reform such as that proposed without a clear understanding of its economic consequences. In Chapter 8 entitled "Impact on Revenues and the Economy", the presence of so many qualifying words such as "may", "should" and "expect" indicates the uncertainty of the economic impact of the proposals thereby emphasizing the desirability of great caution.

The compatability of our Canadian tax system with that of our principal economic and trading partners is a matter of concern. Here again the Honourable Mitchell Sharp, in his Budget Speech of November 1967, in referring to the proposals of the Royal Commission on Taxation, made a statement we believe to be pertinent:

"-----the Commissioners have suggested for Canada a tax system quite different from that of other countries, and in particular quite different from that of the United States with whom we have an integrated capital market. This could give rise to economic difficulties, as well as to technical problems in drafting an effective law."

The CCPA suggests that Canadians are again exposing themselves to the very dangers Mr. Sharp warned against. Canada must realize that it cannot, at its present stage of development and its small domestic market, lead the world in tax experimentation on theoretical grounds if the world is not inclined to follow. Other countries are using their tax systems as well as other means to achieve an attractive economic environment and as an effective weapon in international competition. At its present stage of development, it is impractical for Canada to try to lead the world in tax experimentation. The CCPA is of the opinion that Canada risks becoming isolated from the international trade on which it is so dependent.

THE TAX SYSTEM AS AN ECONOMIC TOOL

The general views of the CCPA are well expressed by Dr. Harry G. Johnson, a well-known Canadian economist who has written:

> "In international economic relations, as in international political relations, you have to start by recognizing the existence of other nations and the fact that they have policies which are designed to suit their interests and not yours. This means you have to work in your international economic policy with their policies as they are, possibly as they might be modified by argument, and not to build your policy on the assumption that other nations will change their policies to suit your convenience. It seems to me that this assumption is very important in considering the current Canadian problem. There is a strong, well-established, and I think dangerous tendency in Canadian thinking about these matters to turn Canadian trade interests into general principles of moral conduct in international affairs, and then to try to persuade other nations to abide by these principles out of sheer ethical high-mindedness; and then to go on to expect other countries to abide by these principles as if they really believed them as firmly as we do; and finally to wind up by critizing them for departing from the pure milk of the word".

There are examples of the salutary results to be gained from the effective use of national taxation policies. Belgium and Holland are striking illustrations; both are small countries with a limited home market, although admittedly members of the much larger European Economic Community. These countries established their economic objectives, created a favourable economic environment and attracted significant investment. This was achieved under a policy which used incentives including investment tax credits, interest subventions, generous capital cost allowances, investment grants, provision of services, and the acceptance of the use of tax havens as a necessary competitive tool in international trade.

THE COST OF RETENTION AND MOTIVATION OF KEY PERSONNEL

White Paper - Paragraphs 8.36 and 8.39

Paragraph 8.36 recognizes that progressively high taxation can have an adverse effect on the willingness to work. Paragraph 8.39 also recognizes that persons at middle and higher income levels are taxed at higher levels in Canada than in the United States.

Comment

Despite this recognition, the government proposes to widen this gap and increase the tax burden on these people with the suggestion that high pay scales be used to compensate "for those individuals or scarce categories who must be retained or attracted against U.S. competition". Today's "scarce categories" are not necessarily tomorrow's and such action will result in disruption to pay schedules with spillover into other categories thus increasing costs and adversely affecting the competitiveness of Canadian business. It could also invite retaliatory action to attract and retain such people. This incidentally adds to the inflationary spiral.

The White Paper proposals have the effect of shifting the tax burden from the lower income groups and from the higher income groups (admittedly they will be caught by the proposed capital gains tax) into the middle income group. The people in the middle income group are important contributors to the economy representing the country's major talent pool and they are already being over-taxed compared with their counterparts in the United States. It is very important to Canada to attract and retain highly competent personnel in the scientific and managerial functions. The very people that Canada needs the most are those most likely to have their incentive and effectiveness reduced by high rates of personal taxation.

These proposals give the CCPA great concern because the chemical industry must attract and retain highly competent people in this income range if it is to prosper and further contribute to Canada's development. Because of its high technological content the chemical industry finds it necessary to transfer scientific and managerial personnel across international boundaries. The proposals in the White Paper requiring payment of capital gains tax on "deemed" realization when leaving Canada, together with the higher incidence of tax while in Canada will make it even more difficult and costly to transfer personnel in the manner they should be transferred to achieve maximum corporate development and maximum development of the individual.

INCENTIVE TO SMALL BUSINESS

White Paper - Paragraphs 4.19 through 4.33

In these paragraphs the Government outlines its proposals to eliminate the lower rate of taxation on the first $35,000 of business income.

Comment

This proposal presents no real problem to big business, but it could have a serious adverse effect on small business, which is at a distinct disadvantage in the capital market, though it has a relatively greater need for capital funds in order to achieve some assurance of continuity through growth. Once again incentive can be made to work. If the small businessman takes his profits into his personal income he will be taxed at personal rates of tax. If, however, he decides to leave the money in the business and reinvest it he will contribute to the future growth of Canada. These people who plough back their earnings into new productive facilities are the type of people Canada needs and should encourage. The CCPA, therefore believes that a lower rate of tax on smaller earnings is an appropriate incentive to new investment that should be retained. As a minimum, if the low rate is to be removed, then new or expanding businesses should be provided with some incentive for growth, e.g., an enlarged capital cost allowance under carefully defined conditions. Many of these small entrepreneurs are important customers of the larger companies and they make an important contribution in finding new uses for products in Canada, and providing feedback from the market place in developing new products.

PART 2

IMPACT ON INVESTMENT CAPITAL AVAILABILITY

THE NEED FOR CAPITAL

Little more than two years ago (November 30, 1967) the Honourable Mitchell Sharp, then Minister of Finance, made the following statement in his Budget Speech:

> "------Canada will need to generate and invest a large volume of savings over the next decade in order to carry out the economic growth and development we want, and we shall need to attract substantial amounts of foreign capital to supplement our own savings".

The CCPA shares the views expressed by Mr. Sharp and finds them strangely at variance with those contained in the White Paper, some of which are as follows:

DOMESTIC SAVINGS REDUCED

White Paper - Paragraph 8.41

> "-----we obtain a total reduction of saving of about $150 million in the first year of the new system and about $525 million in the fifth year-----."

Comment

The government is apparently proposing a system that moves in the direction of encouraging consumption and reducing saving. The CCPA believes that Canada should be moving in the opposite direction. Savings or capital formation provide the base for further economic progress. Canada is presently reinvesting about 25% of its Gross National Product. Japan is reinvesting in the order of 35%. Tax reform aimed at reducing the degree of saving does not appear to be the best policy for Canada's young and vigorous economy.

Canada's historical dependence upon foreign capital for industrial development is thoroughly documented. We are unaware of any trends which will lessen this need in the future. Indeed the world is now in a period of acute capital shortage.

For many years Canada has imported a high proportion of its capital requirements from the U.S. This has been possible because U.S. investors were comfortable with their Canadian neighbours and because the management of Canadian operations did not pose major legal and other problems. Today the U.S. is no longer hesitant to export capital to other countries where wage rates, taxes and other costs are lower than those of Canada.

Moreover, other countries with no long tradition of investment in Canada make their foreign investments where they will earn the highest return. Canada can no longer assume it will automatically obtain from abroad whatever capital it needs. This is no time for Canada to take steps to reduce the flow of foreign capital so urgently needed for growth.

It is also important to recognize that we obtain more benefit from the investment of domestic savings by Canadians but the proposals appear to be content to reduce this source.

The CCPA believes these trends run contrary to our national interests, for economic growth can only be attained through the investment of capital or savings, whether by Canadians or foreigners. Accordingly we believe we must channel the maximum percentage of national income to saving and investment and the minimum percentage to non-productive activities. The cost of Government should also be constrained to an essential minimum. We would go even further and recommend that we should develop an economy which is investment oriented. This implies that the flow of wealth from investment should be redirected towards still more growth and that the tax structure should be aimed at encouraging and rewarding this process.

ATTRACTION OF FOREIGN CAPITAL

In view of the importance which we attach to our needs for capital we believe there should be worthwhile incentives to foreign investment. The White Paper proposals are, at best, passive as illustrated below:

White Paper - Paragraph 6.1

"------our tax system does not seek to discourage non-residents from investing ------in Canada."

Comment

We believe that the circumstances and the logic call for encouragement of foreign capital.

White Paper - Paragraph 6.9

"------it is in Canada's interest as a substantial capital importing nation to maintain an international climate hospitable to the unrestricted flow of capital across international boundaries".

Comment

We agree with this statement but believe the measures proposed in the White Paper are such that they will impede more than assist this desirable objective. The following extract makes our point clear.

White Paper - Paragraph 8.50

"In total, therefore, we expect the result of these tax changes to be a modest reduction of the inflow of foreign equity capital into Canada------"

Comment

As indicated above, we believe this to run contrary to Canada's best interests.

CAPITAL COST ALLOWANCES

The proposals for tax reform include some mention of capital cost allowances and in alluding to the satisfactory aspects of these allowances there is the following statement:

White Paper - Paragraph 5.14

"Nevertheless some have suggested that they are too generous and the government believes that after 20 years of the system it is time for a review.
-------Therefore the government intends in due course to invite briefs on the system and rates of capital cost allowance."

Comment

The fact that a taxation system is under review gives rise to considerable uncertainty in the business community. This has been the case since 1965 and the clear inference in the above statement is that further changes are

still being contemplated. Again the government is looking at only part of the system. In a highly capital intensive industry such as the chemical industry, capital cost allowances are extremely important. To propose reformation of the tax system with the suggestion that capital cost allowances may be too generous, but will be considered later, raises uncertainties that can only have a negative effect on investment until the rules are known. The taxpayer is entitled to know the minimum capital cost allowances applicable for the life of an investment at the time the investment decision is taken. The government is undoubtedly aware of the significant beneficial effect that the creation of Class 19 (50% write-off) assets had on the Canadian economy. Admittedly such fast write-offs resulted in less tax payments by business but they also resulted in greater "saving" for the country through investment in new productive facilities rather than "consumption" which the White Paper proposals will encourage. Capital costs are an expense of running a business in the same manner as current costs (the chief difference being the rate in time when they are absorbed) and a good case can be made for permitting businessmen to absorb them against taxable income at any rate they choose. Such costs can only be written off once in this country. It is realized that fast write-off provisions have the effect of deferring tax payments but they also have the salutary effect of attracting investment and thus increasing "saving" by the nation rather than "consumption". The CCPA realizes that many corporations carry significant "deferred tax" amounts on their Balance Sheets as a result of fast write-offs and further realizes that the government must look longingly at these millions of dollars as potential revenue. Nevertheless if one examines the consequences of such a policy, it will be found that it is an effective incentive. The only way a business can maintain such "deferred tax balances" is by replacing the expiring deferments with new deferments, which of course means new investment. New investments create new jobs at once and these jobs create tax revenue at once.

From a national revenue point of view, deferred income taxes on corporate balance sheets are offset in whole or in part by current taxes on increased economic activity This is an extremely powerful fiscal tool which in the opinion of the CCPA should be used to its maximum extent by the government to encourage new investment. Since capital costs can be written off only once, the importance of this tool rests upon the timing of the write-off and is thus a matter of the value of the time-cost of money. The cost of borrowing by the government to fill any void in revenues that might be created by such tax deferments will be one of the best investments the government can make to spur the economy towards greater saving and therefore faster growth. The White Paper proposals apparently have accepted the principle outlined above with respect to the mining industry whereby it would be permitted to write off capital costs as quickly as it desires. Since risks in many industries are at least as great as in the mining industry, it follows that if this principle is applicable for the mining industry it should also be appropriate to other selected industries. The CCPA believes that maximum flexibility for the taxpayer in this area has the potential of contributing significantly to the Canadian economy.

THE PROPOSED CAPITAL GAINS TAX

We believe the relative immaturity of the Canadian economy compared to that of the United States suggests that the introduction of a full capital gains tax at this stage in our development is inappropriate.

The government should consider the practicability of imposing the proposed capital gains tax only on short-term gains of a speculative nature and retaining the exemption on true long-term investments. This would encourage long-term investment and discourage speculation.

Insofar as the White Paper proposals are concerned, the CCPA believes it is fundamentally wrong to tax gains before they are realized and therefore takes exception to the proposed quinquennial evaluation procedure which could force taxpayers to liquidate assets in a possibly unfavourable market in order to pay the tax. The proposed valuation procedure also has interesting prospects concerning the holdings of foreign shareholders in Canada when the stock is also traded on Canadian exchanges. Surely Canada could hardly expect that American industry would now happily expose itself to Canadian capital gains tax by the mere surrender of a portion of their equity in Canadian subsidiary operations---"good corporate citizenship" guidelines notwithstanding. Good corporate citizens of the past who followed the government guidelines and listed their stock in Canada for purchase by Canadians may now in fact be penalized by being categorized as a widely-held corporation and having their stock valued for the quinquennial valuation with attendant imposition of capital gains tax.

A further concern the CCPA has with the proposed capital gains tax revolves around the subject of inflation. The monetary capital gain arising on realization of assets or as a result of the quinquennial revaluation may be nothing more than the results of inflation with no real gain in terms of purchasing power or ability to replace the realized assets. If such were the case the taxation of such gains on a monetary basis in effect could be a confiscation of real capital. The government should consider the possibility of incorporating an inflation correction factor into its proposal to tax capital gains.

In any event, if capital gains are to be taxed the CCPA believe they should be on a rate structure separate from and considerably below income tax rates, and also below U.S. rates. The prospect of a capital gains tax underscores the need to re-examine the significant dis-saving impact of the 1968 estate and gift tax amendments. Such a double burden cannot help but erode pools of efficiently employed capital in the private sector.

PART 3

IMPACT ON COMPETITIVE POSITION IN DOMESTIC AND WORLD MARKETS

CHEMICAL INDUSTRY ASPECTS

In 1969 the Department of Industry, Trade and Commerce and the Canadian Chemical Producers' Association completed a joint study of the chemical industry in Canada. The conclusions are well known by both government and industry officials, viz. the Canadian chemical industry has very special problems relating to scale brought on by rapidly advancing and sophisticated technology in foreign countries and the very small scale of the Canadian market. The study revealed that taxation was an important factor contributing to the poor competitive position of the industry when compared with the chemical industry in other countries, particularly the United States which is our principal chemical trading partner.

If Canada is to have a healthy chemical industry, attractive to new investment and competitive in world markets, an improved economic environment must be provided. The problem is particularly accute in the light of the recent Kennedy Round of tariff reductions, the increasingly adverse balance of trade in chemicals and the actions of other nations aimed at improving both the international competitiveness of their chemical industry and the attraction of new investment in that industry.

POTENTIAL IMPACT OF PROVINCIAL TAXES

Under Canada's federal system it is extremely important that the provinces do not move in to tax industry in fields left open by the national government for industry to become more competitive. For example, if the federal government accepts the contention that too great a proportion of the national tax requirements are coming from direct taxes on corporation, that this places Canadian business at a competitive disadvantage in international trade and that, in view of these conditions they provide some relief, but the province moves in to nullify such relief, then the international competitive advantage would be lost.

EXTENT OF DIRECT TAXATION ON CORPORATIONS

In the White Paper proposals it is the apparent intention of the government to seek an even higher proportion of its revenue from direct taxes on corporations whilst other countries are moving towards improving the international competitiveness of their industry by raising a greater proportion of their revenue from indirect taxation which is not applicable to exports, and subject to the imposition of border taxes under the GATT rules.

To the extent that corporation taxes are reduced and indirect taxes correspondingly increased, Canada's competitive position would be improved in two ways; Canadian goods could penetrate further and in greater volume into export markets because of the decreased tax cost; the decreased corporate tax cost and the benefit of added volume would also permit the Canadian producer to sell at lower prices domestically vis-a-vis the foreign competitor and the higher indirect tax, bearing equally on imported (at the old cost) and domestically produced (at the now lower cost) goods, the domestic producer would have an improved competitive position against imports.

White Paper - Paragraph 1.20

"------Finally our corporation income taxes are already high by international standards; further increases would be damaging to our economic development and competitive ability, making it more attractive to locate industries in other countries."

Comment

While the White Paper says it recognizes the international competitive burden of corporation taxes it does not propose the shifts necessary to enhance Canada's international position. We agree that international investors scan the international tax horizons when making decisions where to locate a plant. Here is the picture as seen by the U.S. investor considering the alternative of a large scale plant in Canada or the U.S.: A 48% tax cost in the U.S. against a 50%-53% cost in Canada plus a further 15% withholding tax cost on remission of the dividends for a total in the order of 57-1/2% - 60%, plus the prospect of a capital gains tax. To overcome these disadvantages, to attract international capital and to improve our international competitive position the CCPA believes that Canada's corporate tax rate should be slightly "tax haven" relative to the U.S. and that greater reliance be placed on indirect taxes.

PROPOSALS RESULT IN COMPETITIVE DISADVANTAGE

In view of the tactics and devices of other countries, the CCPA is concerned by the trend of the Paper towards the concept of neutrality in taxing foreign source income and domestic source income. Such a concept assumes that the competition is the same in all markets. This is not the case. Canadian exports and

Canadian-owned facilities abroad compete with foreign rather than Canadian industry and in international rather than Canadian markets. Canadian companies competing for international markets should be provided with a tax environment at least as favourable as their competitors enjoy. The margin on foreign trade is often so thin that the incidence of tax represents the difference between acceptance of the business with all of its risks or foregoing the business. This is particularly important for Canada whose dependence on international trade represents in excess of 20% of the Gross National Product.

The White Paper proposes to introduce legislation similar to the United States legislation on foreign source income. The United States dependence on international trade amounts to only 5% of its Gross National Product. The potential impact on the Canadian economy of making its business less competitive in international trade is far greater than is the case in the United States. The CCPA believes it is unwise to import the foreign source income provisions from the United States tax law.

OVER-REACTION TO ALLEGED ABUSES

The CCPA agrees with the objectives of the government aimed at closing loopholes and abuses by use of tax havens. However, it does not follow that all income must be taxed at Canadian rates. Taxpayers in many jurisdictions who are competing with Canadian taxpayers for international markets are not taxed at such high rates as the Canadian rates and many countries are willing to let their taxpayers utilize tax havens to permit them to be more competitive in international trade. Canada should recognize these realities and not legislate her own taxpayers into a less competitive posture.

The CCPA believes that in over-reacting to current taxation abuses, all of which could be corrected without a major revision of the tax structure, the White Paper proposals may well further inhibit the international competitiveness of Canada industry. Legislation can be enacted to control tax avoidance without impairing bona-fide foreign operations that are necessary to help Canadian industry to be competitive in international markets.

PART 4

OTHER AREAS OF CONCERN

The C.C.P.A. finds there are a number of proposals of varying importance which fall outside of the three major categories within which we have chosen to group our preceding comments. These are set out below together with our comments.

COMPLEXITY

Not least among the hazards of a major revision in any tax system is the confusion and complexity surrounding preparation of the tax forms. In regard to this the government makes the following declaration:

White Paper - Paragraph 1.24

"The form of the personal income tax would be streamlined, greatly simplifying the individual's task in calculating his tax."

Comment

We believe that the structure recommended in the White Paper would be so complex that a large percentage of Canadians would no longer be capable of preparing tax returns. It would add many complications to the most simple transactions, such as owning a house, and it would impose the tax collectors' judgment on innumerable business transactions. We suggest that the total cost involved in making and assessing tax returns on such items could be out of all proportion to the tax revenue resulting.

INTEGRATION

The proposals to integrate personal and corporate taxation are considered by the C.C.P.A. to introduce both unnecessary complexities and disadvantages far outweighing any advantages which might arise therefrom. Adoption of integration necessitates the adoption of a host of complex subsidiary rules (2-1/2 year force out, stock dividends) which create a new range of conflicting pressures and priorities for management. Integration will expose Canada to extreme pressures in negotiating certain tax treaties. In contrast, we feel that the form of the present dividend tax credit system, which is simple, workable and easily understood, could be enlarged to provide an increased incentive for Canadians to invest in Canadian equities.

COOPERATIVES

The C.C.P.A. is surprised that a paper which makes so much of the principle of equity should leave relatively unchanged the discriminatory favourable tax status of the Cooperatives. Many Cooperatives are complex business enterprises, separate from their members, and should be subjected to the same taxation as their competing commercial counterparts. As a minimum, unless patronage dividends are paid in cash, we do not believe they should be deductible for tax purposes.

EXPENSE ACCOUNTS

The White Paper proposes to go beyond eliminating abuses arising out of expense account living. The C.C.P.A. certainly does not object to eliminating abuses, particularly so since we are convinced that such abuses would not be practiced by responsible businesses, and in any event, deduction of such expenses would seem to be prohibited by existing law. However, in disallowing all entertainment and convention expenses, the C.C.P.A. believes that the government is over-reacting. The disallowance of such expenses would in effect be a hidden tax increase. Business luncheons and dinners, attendance at conventions, travelling to hold discussions with business associates are all very necessary expenses to earn the business income. The C.C.P.A. believes that the present law in this respect provides the government with an adequate vehicle to control the situation and it is just a matter of enforcing the law. If the government feels that the existing law is inadequate in this respect it should propose amendments requiring that expenses must be better documented. Complete prohibition of deduction of normal entertainment expenditures is unrealistic and will put Canadian business at a further disadvantage in international business where such expenses can indeed be extremely important. The government has been expounding the theory of participatory democracy and has supported the use of trade organizations and industrial organizations. Such organizations are good for the country and the expenses incurred in attending their meetings should be deductible for tax purposes.

APPENDIX "F"

NAME: THE CANADIAN CHEMICAL PRODUCERS' ASSOCIATION

Analysis of Appendix "E" by Senior Advisor

This brief is submitted by The Canadian Chemical Producers' Association, an association of 43 companies with plants located throughout Canada and employing some 75,000 persons.

The brief deals with the following subjects:

1. Impact on economic growth and productivity. (Pages B-1 and B-2 of Sections B and C Part 1 of the brief).

2. Impact on investment capital availability. (Pages B-2 and B-3 of Sections B and C Part 2 of the brief).

3. Impact on competitive position in domestic and world markets. (Page B-3 of Sections B and C Part 3 of the brief).

4. Other areas of concern. (Pages B-3 and B-4 of Sections B and C Part 4 of the brief).

The attention of the Committee is drawn to the following comments:

1. "Various statements in the White Paper imply that the high level of Canadian taxes is both justified and necessitated by public demand for more and more governmental services. While appreciating the political pressures, we believe the Government is elected to lead rather than to follow. Implicit in leadership responsibility is the need to decide upon priorities. We do not believe that any government can legislate properity; rather, we as a nation must earn it. This presupposes some economic laws and some economic constraints which must take precedence over public "demands" which, traditionally are unending."
(Page A-2 of Section A of the brief).

2. "Our study of the proposals leads us to suggest that insufficient attention has been given to the international aspects of life in our "global village". Canada, being largely dependent upon foreign trade, is in a vulnerable position. The rising trade imbalance in chemicals underscores the need to enhance our ability to compete for world markets and the essentiality of our tax and economic system being both competitive and compatible with that of our major trading partners."
(Page A-3 Section A of the brief).

3. "Finally, we find ourselves gravely concerned about the world shortage of capital and Canada's ability to compete successfully in the increasingly intensive competitive environment brought about by international corporations. Estimates indicate it takes $15,000 to $20,000 in capital to provide the tools for each worker. If one but multiplies this by the numbers entering our Canadian work force each year, it provides a dramatic illustration of our near-future capital needs."
(Page A-3 Section A of the brief).

4. "CCPA agrees there is a continuing need to spur certain activities and that the tax system should be used in this way.

However CCPA questions if the proposals are in keeping with the stated policy when they result in: reduced national saving; a reduction in incentive

by taxing capital gains at high rates; a dampening of investment enthusiasm by suggesting that capital cost allowances may be too high; continuation of high effective tax burdens on corporations relative to many countries; legislating Canadian business into a less competitive position in international markets by proposing to import United States law concerning foreign source income; and reduced incentive to reinvestment in small business."
(Page B-1 Section B of the brief).

5. "CCPA believes the relative immaturity of the Canadian economy compared to the United States suggests that the introduction of a full capital gains tax at this stage in our development is inappropriate.

CCPA believes it is fundamentally wrong to tax capital gains before they are realized and therefore opposes the proposed quinquennial evaluation procedures.

If Canada must have a capital gains tax CCPA suggests that it apply only to realized gains and at significantly lower rates separate from normal income and with an adjustment factor for inflation."
(Pages B-2 and B-3 Section B of the brief).

6. "CCPA considers it fallacious to assume that all income must be taxed at Canadian rates when companies located in other countries, with whom we must compete, enjoy lower rates in their own jurisdiction or in other jurisdictions where they create marketing or licensing companies."
(Page B-3 Section B of the brief).

7. "CCPA suggests that implementation of the White Paper proposals will produce a complicated tax system which will result in administrative costs out of proportion to the added revenue collected. This will discourage investors who may take their investment elsewhere."
(Page B-3 Section B of the brief).

8. "CCPA believes the proposal to integrate personal and corporate taxation will result in conflicting pressures that will make it difficult for management to serve differing shareholder interests. We therefore believe that the integration proposals of the White Paper should not be adopted, particularly in view of the fact that these proposals represent a complete departure from the tax systems generally in use by other nations which tend to identify the corporation and the individual as separate taxable entities. Enlargement of the dividend tax credit system would appear to take care of the problem of incentive for investors and would minimize tax treaty negotiation problems."
(Pages B-3 and B-4 Section B of the brief).

9. "The CCPA agrees with the government's intention to eliminate abuses with respect to expense account living but suggests existing law provides all the authority required to prevent abuses. The CCPA does not agree with the proposals to disallow deduction of legitimate expenses necessary to earn income."
(Page B-4 Section B of the brief).

10. "Other countries are using their tax systems as well as other means to achieve an attractive economic environment and as an effective weapon in international competition. At its present stage of development, <u>it is impractical for Canada to try to lead the world in tax experimentation.</u> The CCPA is of the opinion that Canada risks becoming isolated from the international trade on which it is so dependent."
(Page C-4 Section C Part 1 of the brief).

11. "The White Paper proposals have the effect of shifting the tax burden from the lower income groups and from the higher income groups (admittedly they will be caught by the proposed capital gains tax) into the middle income group. The people in the middle income group are important contributors to the economy representing the country's major talent pool and they are already being over-taxed compared with their

counterparts in the United States. It is very important to Canada to attract and retain highly competent personnel in the scientific and managerial functions. The very people that Canada needs the most are those most likely to have their incentive and effectiveness reduced by high rates of personal taxation."
(Page C-6 Section C Part 1 of the brief).

12. "The CCPA, therefore believes that a lower rate of tax on smaller earnings is an appropriate incentive to new investment that should be retained."
(Page C-7 Section C Part 1 of the brief).

13. "The prospect of a capital gains tax underscores the need to re-examine the significant dis-saving impact of the 1968 estate and gift tax amendments. Such a double burden cannot help but erode pools of efficiently employed capital in the private sector."
(Page C-13 Section C Part 2 of the brief).

This brief does not lend itself to the preparation of the usual summary of present income tax law, White Paper proposals and principal points of the brief.

Queen's Printer for Canada, Ottawa, 1970

Second Session—Twenty-eighth Parliament

1969-70

THE SENATE OF CANADA

PROCEEDINGS

OF THE

SPECIAL SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 28

THURSDAY, MAY 28th, 1970

Twenty-Second Proceedings on the Government White Paper, entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 28:5)

APPENDICES:

"A"—Brief from Hudson's Bay Oil and Gas Company Limited.
"B"—Analysis of Appendix "A" by Senior Advisor.
"C"—Brief from Aquitaine Company of Canada Ltd.
"D"—Analysis of Appendix "C" by Senior Advisor.
"E"—Brief from International Utilities Corporation.
"F"—Brief from King Resources Company and its Canadian employees.
"G"—Analysis of Appendix "F" by Senior Advisor.
"H"—Letter and Memorandum to brief from James Richardson & Sons, Limited—as printed in Issue No. 22, dated May 7, 1970.

22089—1

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird
Aseltine
Beaubien
Benidickson
Blois
Burchill
Carter
Choquette
Connolly (*Ottawa West*)
Cook
Croll
Desruisseaux
Everett
Gélinas
Giguère
Grosart
Haig
Hayden
Hays
Hollett
Isnor
Kinley
Lang
Leonard
Macnaughton
Molson
Phillips (*Rigaud*)
Walker
Welch
White
Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

22089—1½

MINUTES OF PROCEEDINGS

Thursday, May 28th, 1970.
(43)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aird, Beaubien, Benidickson, Burchill, Carter, Connolly (*Ottawa West*), Desruisseaux, Everett, Gelinas, Haig, Hays, Hollett, Isnor, Kinley, Molson, Phillips (*Rigaud*), Welch and Willis—(19).

Present, but not of the Committee: The Honourable Senators Smith and Urquhart—(2).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES: *Hudson's Bay Oil & Gas Co. Ltd.*

Mr. L. J. Richards, President;

Mr. F. J. Mair, General Manager, Administrative Services.

Aquitaine Petroleum Company.

Mr. A. Dumestre, Exploration Manager;

Mr. N. Phillips, Q.C., Counsellor.

International Utilities Corporation.

Mr. Dennis K. Yorath, Chairman, Executive Committee;

Mr. Murray E. Stewart, Group Vice President;

Mr. Robert M. Baxter, Vice President;

Mr. Daniel S. Brennan, Director of Taxation;

Mr. Neil Phillips, Q.C., Counsel;

Mr. John E. Maybin, Chairman and Chief Executive Officer, International Utilities Western Canadian Subsidiaries.

King Resources Company and its Canadian Employees.

Mr. H. Neil S. MacKenzie, Vice President;

Mr. R. Gail Duffy, Assistant Division Manager;

Mr. Glenn E. Holmes, Division Financial Manager.

At 12:30 p.m. the Committee adjourned.

AFTERNOON SITTING

At 2:15 p.m. the Committee *resumed.* 2:15 p.m. (44)

Present: The Honourable Senators Aseltine, Benidickson, Burchill, Beaubien, Carter, Cook, Everett, Gelinas, Haig, Hollett, Isnor and Kinley—(12).

*The Honourable Senator Everett *Acting Chairman* in the Chair.

WITNESSES: Continuing with King Resources Company and its Canadian Employees.

Ordered: That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from Hudson's Bay Oil and Gas Company Limited.

B—Analysis of Appendix "A" by Senior Advisor.

C—Brief from Aquitaine Company of Canada Ltd.

D—Analysis of Appendix "C" by Senior Advisor.

E—Brief from International Utilities Corporation.

F—Brief from King Resources Company and its Canadian employees.

G—Analysis of Appendix "F" by Senior Advisor.

H—Letter and Memorandum to brief from James Richardson & Sons, Limited—as printed in Issue No. 22, dated May 7, 1970.

At 3:30 p.m. the Committee adjourned to the Call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Thursday, May 28, 1970.

The Standing Senate Committee on Banking, Trade and Commerce met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, I call the meeting to order. We have four submissins today and we intend to proceed first with the submission of the Hudson's Bay Oil and Gas Company Limited. Before doing that I thought I should bring to your attention a letter and a memorandum which I received from James Richardson and Sons, Limited. I should like to read it and make it part of the record of today's proceedings.

The letter addressed to me, dated May 20, reads as follows:

> Dear Senator Hayden,
>
> I would like to express our appreciation of the very cordial manner in which our brief was received in your committee on May 7. We particularly enjoyed the manner in which the question period developed and the general atmosphere which permitted a free and easy exchange of ideas.
>
> Near the completion of the hearing Senator Phillips asked our view on whether or not the economy of the country was being affected during the period of debate in respect to the White Paper. While I believe we stated quite definitely that in our opinion there was a very serious detrimental effect during the period of uncertainty, we perhaps did not stress this view strongly enough. We could document several rather important potential developments which we know are being deferred but unfortunately the really important ones cannot be publicized at the moment.
>
> As part of this discussion Senator Phillips raised the question as to what might be done to remove some of the uncertainty which undoubtedly is far more detrimental than many people appreciate. In the attached memorandum we have attempted to provide a more definite answer to Senator Phillips' questions and subject to your approval, we would like to have the memorandum brought to his attention and added to the proceedings of May 7.

The proceedings of May 7 have already been printed so that we cannot add anything to the proceeding of that date. But we can include the letter as part of the proceedings for today.

Hon. Senators: Agreed.

The Chairman: I have given a copy of the memorandum to Senator Phillips (Rigaud). I think the committee would be interested in hearing it, because James Richardson and Sons wanted it to be consdiered as part of the brief they presented on May 7.

Hon. Senators: Agreed.

The Chairman: The memorandum reads as follows:

> In answer to questions raised by Senator Phillips, we endeavoured to establish our concern regarding the serious detrimental effect to the business community during the period that the White Paper proposals were being debated. We would like to emphasize that this gives our firm very real concern and we think the Government of Canada should remove some of these uncertainties.
>
> From the point of view of economic environment, it appears desirable to remove the most pressing problems as they affect business decision. The problem is to accomplish this purpose without destroying the very valuable process which is taking place within the parlia-

mentary committees assisted by the contributions of concerned citizens. The implications of the integration proposals are so arbitrary and destructive and create such massive problems that some other method must be found in attempting to achieve the objectives of the White Paper. Abandonment of the integration proposals and some minimum assurances, more realistic than those in the White Paper, respecting the extractive industries and, in particular, mining, should clear the air meantine. If your committee could agree on the substance of the integration question and upon appropriate mineral incentives, an interim report to that effect might enable the Government to reduce business uncertainties. Your committee probably would find it easier to recommend abandonment of integration than to determine what minimum assurances are necessary for the extractive industries but it seems to us that both should have high priority.

Your committee has heard a number of valuable briefs as they affect the extractive industries and you might be able to reach a conclusion as to what incentives, if any, are desirable. We believe that the international dependence of the mining industry for capital and markets requires a different tax treatment from other industries. A provision for depletion is an effective and simple method of reducing the corporate tax burden without establishing separate industry tax rates. In considering the merit of the present tax free period, it might be considered advisable to limit the tax free period to three years or until some fixed percentage of the capital cost is recovered, whichever is the sooner.

The Government could, at the same time, defer the capital gains provisions (if any), particularly the five year revaluation proposal and defer the institution of the proposed personal rate schedules and personal exemptions until the parliamentary committees can report and the provinces have made their views known on these questions. With the abandonment of the intergration proposal, it would be practical to continue fiscal incentives to defined small business until the parliamentary committees have made recommendations as to the manner in which best to provide realistic assistance to small business.

We put forward the foregoing as a suggestion which might resolve some of the immediate undertainties without abandoning, or appearing to abandon, tax reform or the procedure of public involvement, both of which appear to us to be very valuable.

Now is it the view of the committee that this should be part of the proceedings today?

Hon. Senators: Agreed.

The Chairman: Now I should bring to your attention the fact that there was a letter from the Department of Paediatrics of The Hospital for Sick Children in Toronto to advise us, and I read as follows:

At a meeting of the medical staff of the Hospital for Sick Children held at the Hospital on Wednesday, April 29, 1970, a resolution was passed unanimously endorsing the submission of the Canadian Medical Association (including its appendix) to the Standing Senate Committee on Banking, Trade and Commerce, dated April 1970.

We trust that this resolution will receive consideration from the Standing Senate Committee.

And then a letter also came in from the Industrial Acceptance Corporation Limited, and they say:

In the matter of the Government White Paper entitled, "Proposals for Tax Reform" now being studied by the committee, we wish to record the following.

Having studied the White Paper and having read a number of the many briefs and other opinions written about it, we have concluded that we should also present our views.

However, to do so by way of yet another brief would inevitably involve some repetition of points already made by others and to that extent unnecessarily take up the time of the committee. Therefore, we present this letter by way of a specific endorsement of the brief submitted by the Executive Council of The Canadian Chamber of Commerce whose delegates appeared before the Committee on April 15th last. That brief expresses very well the major points we would have endeavoured to make had we prepared one of our own.

Respectfully submitted.

I can tell you, honourable senators, the mail still keeps coming in with representations and additional briefs, and I can certainly say that it shows that we have an aroused population in Canada at the present time.

Senator Benidickson: Mr. Chairman, on that point, as you know, I have spoken to you privately, but at the present time we have reason to hope that there will be an adjournment of Parliament, and of course there is another committee at work on this same subject, and they have certain summer plans, I understand. Then of course there is the desire of the Minister to get some advice from these two committees, and probably at some time in the future we will be faced with that. Having that in mind and considering that we only have another month before the proposed adjournment, I wonder if we could have a meeting *in camera* to look back on the points that have been most impressive to the committee, to look at the question of repetition and also to consider the question of how many briefs are still to be dealt with so that everybody may have an appreciation of the uncompleted task.

The Chairman: Well, Senator Benidickson, you spoke to me the other day about this, and I was proposing that some time, either on the third or fourth of June, we would find time for a session *in camera* where I can report to you on what we have done, quite apart from committee meetings, and also give an assessment of what happens following recess and get the views of the committee on that. I think plans should be fairly definite by that time and we should know when Parliament proposes to resume. This is a very important factor. We must know that because if we do not, we cannot make any plans. As you can see, if they follow the procedure of previous years where they would meet in late September for one day and then prorogue and have a new session beginning the following day, that would create all kinds of problems, and it certainly would create a very difficult problem in the House of Commons where there would have to be another motion in the new session of Parliament to refer the White Paper to the Standing Committee there and that, I would assume, would involve substantial debate. These are factors that have to be considered; when is Parliament going to resume and how long it is going to carry on before they prorogue. These are important questions, but we may have the answers by next Tuesday or Wednesday.

In any event, we will have a meeting *in camera* but I can tell you that the staff, including the Chairman and the Vice-Chairman, have not been idle in organizing in respect of the analysis of the transcripts of the proceedings of the committee, all the briefs and discussions that have gone on, the analysis of the briefs—those heard and those that have not yet been heard, and we have been thinking in terms of what we will have to do some day, that is to prepare a draft report and submit it to the committee. So, honourable senators, you will see that we have not been idle.

Senator Benidickson: It seems to me that that meeting should be held on a date when Mr. Gilmour can be present.

The Chairman: He will be here next Wednesday and our committee meeting is likely to be held in the afternoon of next Wednesday.

Senator Carter: Mr. Chairman, are there any studies under way now that have not been completed, and are we doing any studies on the impact of the White Paper proposals? We have had two assessments; the one in the White Paper says that $650 million, and in the Ontario submission, they mention the sum of $1 billion. Has any study been going on to see which one of these is the more accurate?

The Chairman: Well, without developing what they are, because I do not think I should do that at this stage, there are certain studies being done in relation to some of the figures and proposed tax rates and things of that kind to see what answers we can come up with. One significant point, for instance, is that table 15 of the White Paper shows a loss of tax revenue of $1 billion in the first year and the fifth year as a result of the increase in the exemptions. But if you look at the next line in that table you will see that the recovery by increased tax rates in the first year and the fifth year are set at $1,255 million. I mean, if you can do it, it is good business to recovery more than you lose, but the question is how necessary is it, and to what extent could the higher rates in the middle grouping be reduced if you were to recover only $1 billion instead of $1,255 million. There are a number of other questions that we are analysing.

Honourable senators, our first witnesses this morning are from the Hudson's Bay Oil and Gas Company Limited, represented by Mr. L. J. Richards, Chairman of the Execu-

tive Committee of the Board of Directors, Mr. Mair, General Manager, and Mr. Humeniuk, Manager of the Tax Department.

Mr. Richards is going to make the opening statement.

Mr. L. J. Richards, Chairman Executive Committee, Board of Directors, Hudson's Bay Oil and Gas Company: Mr. Chairman and honourable senators, Mr. Mair, Mr. Humeniuk and I are pleased to have this opportunity to meet with you today on this important matter of tax reform. It is my intention to make a brief opening statement after which we would invite your questions concerning our submission and the petroleum industry. With your permission, I will refer the more technical questions on taxation to Mr. Mair who has been intimately involved in tax work for many years.

I have been associated with Hudson's Bay Oil and Gas since the company was reactivated following the discovery of oil at Leduc, Alberta in 1947. During these years I have seen it grow from a very modest beginning to a company that is now fifth or sixth largest within the Canadian petroleum industry. The evolution of Hudson-Hudson's Bay Oil and Gas to its present position is outlined in an exhibit with our submission and further repetition is unnecessary—except to emphasize the importance of tax incentives under which this expansion was accomplished. In the initial stages of our development these incentives attracted risk capital from foreign sources and subsequently allowed us to raise capital in Canada to the maximum extent possible.

We are most concerned that the White Paper's proposals will adversely affect the ability of Canadian corporations including Hudson's Bay Oil and Gas, to raise the capital required for their future growth. This situation will be particularly acute for companies whose income tax payments are not a substantial portion of their pre-tax earnings and hence will not have the optimum of creditable tax to pass on to their shareholders.

In addition, the proposals as outlined in the White Paper will seriously reduce the amount of Canadian capital available for investment and discourage the foreign capital,—both of which are necessary to help develop the Canadian economy at an optimum rate of real growth. I do not disagree in principle with equity in taxation,—but it should not be achieved at the expense of slower rates of real growth in our Canadian Gross National Product with potentially higher unemployment.

With respect to the petroleum industry, I would like to make the following points:

1) In contrast to other industries, the petroleum industry involves substantially greater investments in acquisition and development costs prior to production.

2) Investments in individual projects within the petroleum industry are of a very long-term nature. For example, the minimum period during which we can sell our natural gas reserves is 20 years and most of our contracts spread our sales out over at least 23 years. Natural gas liquids such as condensate, propane and butane, as well as sulphur, would be sold over similar periods. If we were to discover a 1,000,000 barrel oil reservoir in Alberta it would take us more than 20 years to produce those reserves, even with the prospect of substantial increases in exports of Canadian crude oil.

3) As you can readily visualize, we in the petroleum industry must forecast well into the future when we are committing our capital for investment projects. To assist us in this work, many petroleum companies use discounted cash flow procedures extensively. These evaluation techniques are very sensitive to any substantial increase in taxes and the after-tax return on investment can be drastically eroded by such an increase. In some cases the return could be reduced to the point where the project becomes an inefficient investment with respect to the cost of our capital. The return expected when we began the project might be reduced sufficiently to make us wish we had never undertaken the project.

4) The transitional provisions as proposed appear inadequate and therefore have the effect of taxing retroactively. As a result, unless we continue to explore and develop, the value of our existing reserves will be reduced. These reserves were found and developed on the premise that depletion would be allowed when the Company was taxable. Hudson's Bay Oil and Gas has now reached that position and finds that depletion is to be restricted. Investments made prior to November 1969, have, to my mind, already earned their depletion. Accordingly, it would be reasonable to exempt from the provisions for earning depletion

those developed properties held when the White Paper was issued.

I have not attempted to summarize our entire submission in this opening statement and there are many other important topics in our brief that could be mentioned. With your time at a premium, I shall not dwell upon them except to say that we feel they are worthy of your consideration. Before inviting your questions, I would like to emphasize that our Company does not disagree with or object to reforming the Canadian tax system. However, many of the objectives of the White Paper can be achieved with minor changes to Canada's existing tax system without resorting to measures that are far reaching and untested, and which may have adverse repercussions.

At this time Mr. Mair and I will be pleased to answer any questions you might have.

The Chairman: Honourable senators, while you are thinking of what your opening question might be, there is something you have said in your brief, Mr. Richards, under the heading "Proposals concerning the petroleum industry," on page 1 in the summary, where you say that:

> Hudson's Bay Oil and Gas agrees with the principle of earned depletion but the cost of mineral rights should earn depletion and developed properties held on November 7, 1969 should be exempt from the earning provisions.

Senator Hollett: On what page is that, please?

The Chairman: The first page, Item I, starting right at the beginning.

When I read on further in that paragraph you seem to be qualifying your approval of the principle by discussing the question of depletion being calculated on a gross production basis. In those circumstances, just what do you mean by saying that you agree with the principle of earned depletion?

Mr. Richards: We agree that depletion should be earned by conducting exploration and development activities. We have done that in the past and we have done it on the economic consideration that any success, any production we had would be allowed 33⅓ per cent depletion, as now provided for in the tax regulations and laws.

We believe and feel strongly that, because our economics were based on those tax parameters, we should continue in the future to be given depletion on those properties held and under production prior to November 7, 1969.

The Chairman: That is not quite the question I put to you. The depletion which you enjoy now is up to 33⅓ per cent of net production income.

Mr. Richards: Yes, sir.

The Chairman: And if you spend any money on development then that is a deductible item of expense?

Mr. Richards: Yes, sir.

The Chairman: Now, what the White Paper proposes is that the only incentive you will have is what it calls earned depletion. It proposes that that earned depletion would give you a dollar for every $3 that you spend.

Mr. Richards: Yes, sir.

The Chairman: I am just wondering whether you, in your general language approving earned depletion, mean earned depletion as it is outlined in the White Paper. If you do not mean that then I should like to know what you do mean.

Mr. Richards: We believe that you should earn the depletion, but we are proposing a different formula, and I would like Mr. Mair to speak to that.

The Chairman: Mr. Mair, what I am getting at is that "earned depletion" seems to be a phrasing that the White Paper uses. When you say that you approve of the principle of earned depletion then I conclude that you mean earned depletion as it is stated in the White Paper. If you do not mean that then this is the time to make your distinction.

Mr. F. J. Mair, General Manager, Administrative Services, Hudson's Bay Oil and Gas Co. Ltd.: No, we do not mean it as it is defined in the White Paper. When we say we agree in principle we mean we agree with the theory that if you are going to be given depletion as an incentive in the industry you should use that incentive to do further exploration and development—to carry out further exploration in the country. But, as that phrase is used in the White Paper we think it is too restrictive, and we would suggest, first of all, that if you are going to use the rate of 33⅓ per cent you should include the bonus costs of acreage acquisitions, and if you are not going to include those then it

should be at least 50 per cent so that you would have $1 for every $2 of exploration and development expense you have. In agreeing with the principle we are merely saying that the theory is to give you additional money which you would otherwise pay in taxes to do further exploration and development.

The Chairman: Well, you say that that is the theory, but the White Paper suggests that there are risks inherent in the extractive industry that call for incentives, but it says that the incentives heretofore enjoyed are too much, and therefore...

Mr. Mair: No, I would disagree with that.

The Chairman: You disagree with the statement that the present incentives are too great?

Mr. Mair: I do.

The Chairman: And you disagree with the idea of earned depletion being on the basis proposed in the White Paper?

Mr. Mair: That is true.

The Chairman: Now, what is wrong with the proposal in the White Paper? Why is it not adequate, in your opinion?

Mr. Mair: You have, first of all, to spend the money before you get this tax incentive, and it is too small in relation to the total amount of tax you pay. In addition, we would disagree much more with the principle of integration because although they give us this incentive in the company, through integration it is virtually eliminated when it gets to the shareholders, and the shareholders, who are the true owners of the resource, are denied depletion under the system proposed by the White Paper.

The Chairman: Let us now get away from the base. If depletion as provided for in the White Paper is not adequate then you are proposing a formula in place of that, and a formula which differs from the depletion which now exists?

Mr. Mair: That is true.

The Chairman: You are proposing that the depletion be calculated on the gross production income?

Mr. Mair: That is right.

The Chairman: And you say 20 per cent?

Mr. Mair: Yes.

The Chairman: Would not 20 per cent of gross production income be about the equivalent of a third of net production income?

Mr. Mair: No, sir. The reason why it would not—to use Hudson's Bay Oil and Gas as an example, last year our net production income was relatively small because we still had a large amount of exploration and development expenditure to deduct. Therefore, in calculating it on the net we arrive at a relatively small amount, whereas the gross amount is not affected by the amount of exploration and development that you do. The reason why we claim that the net is an efficient method is that the more exploration and development you do then the less depletion you get. Therefore, we say that it should be calculated on the gross.

The Chairman: Yes, but if you have to find a market for some of your crude oil in the United States then to remain competitive would you suggest that the formula used here for depletion, and otherwise affecting the industry, should bring you closely in line with what the formula is in the United States?

Mr. Mair: That is true. We would like to have a depletion formula that is at least as good as that in the United States. I think in raising capital we have more problems in Canada than has the oil industry in the United States, which is much more mature. We suggest it should be at least as good, and perhaps better than, the formula in the United States.

The Chairman: The formula you suggest is that depletion should be allowed on the basis of 20 per cent of gross production income.

Mr. Mair: That is right.

The Chairman: What is the significance of the word you have used, namely, "earned". Are you suggesting that you should not be entitled to that unless you actually do the exploration and development?

Mr. Mair: Well, I would like to suggest that we would not have to have any limitation at all, but I think, to try to follow the line of reasoning in the White Paper to some extent, we could agree that earning your depletion is a reasonable concept if they broadened the terms.

The Chairman: When you say "broadened the terms"...

Mr. Mair: By that I mean you should be able to include lease acquisition costs in your base, because after all, that is just another exploration and development cost, or the ratio could be increased from $1 for $3 to $1 for $2.

The Chairman: We have had some people here who have indicated—the tar sands people—that if you put that tag on the kind of depletion that you say you want then they could not earn the depletion because they have the resource, and all they have to do is to find a way of taking the sand out of the oil.

Mr. Mair: I agree with that. I do not think the earned concept should be applicable to a mining type of operation. The tar sands operation is a mining type of operation. Those people do not have the opportunity to earn in the same way that an exploration and development company such as ours does. I think that they should have a depletion allowance that is not limited by that concept.

The Chairman: If we move you forward out of your own company and into the industry, then to get a principle which might conform more generally in the industry you would take out those words about having to earn it through exploration and development; is that right?

Mr. Mair: Yes, sir.

Senator Phillips (Rigaud): Mr. Mair, my question will be put to you on the assumption that I do not support the integration plan proposed in the White Paper, and I am taking advantage of the presence of your company here to deal specifically with the problem of incentives in the natural resource industries in relation to the existing statute and any modifications that may be made. I make that statement so that you do not become confused about whether the necessary assumptions are made on the basis of the White Paper. Let us assume that there is no integration, and direct ourselves to this basic problem of incentives in the natural resource industry.

The members of this committee have had some trouble in differentiating between oil companies and mining companies; between ferrous and non-ferrous mining companies; between bonanza companies and those who do not make money, and all that sort of thing.

The question of coming to conclusions as to what type of incentive should be given naturally excites the imagination. Beyond that, one must come to conclusions and we want the assistance of technical men who might guide us, at least in the thinking.

I have raised the question at a previous hearing as follows: public opinion cannot be ignored and generally finds it hard to accept the tax holiday and depletion concepts by way of, I would not say perpetual, but indefinite continuance. It thereby sees situations in balance sheets of profits that bear no relationship to the tax paid. In other words, the profit you report to your shareholders is at considerable variance with your taxable income.

As against that, the consensus of public opinion is intelligent enough to appreciate the necessity of incentives for natural resource industry.

What would you think of a plan whereby the natural resource companies generally are not given a tax holiday or depletion allowances, but that across the board they are subject to a rate substantially lower than that applicable to all other taxpayers, but the taxable income would be determined, obviously, by setting aside tax holidays and depletion at, for instance, a 20 per cent or 25 per cent rate as against a corporate rate of 50 per cent.

Let the chips fall where they may, because chips will fall and hurt. However, this is a possible means to arrive at a basic concept that would be equitable in the end results.

Would you react to that suggestion?

Mr. Mair: Yes, I think that would be a good suggestion if, as you say, it is acceptable to the public.

This is one of the reasons we say we agree with earned depletion. This would be an acceptable proposal where an oil company has to earn its depletion.

I think the public would accept that. There is quite a misconception in the public's mind generally as to the profits earned in the oil industry.

The oil industry is at the bottom of the list of rates of return published by the Canadian Imperial Bank of Commerce. However, the average person believes that the oil companies are rich.

Senator Phillips (Rigaud): I am glad you did not mention the Royal Bank of Canada.

Mr. Mair: Many people feel that everyone entering the oil industry immediately becomes rich. However, we do not find they carry that far enough to invest in our stock. Canadians generally have not been attracted to the oil industry, despite this depletion allowance.

One of the reasons we say it was not effective is that it was calculated on net income. Therefore, most companies have not had the benefit of any depletion up to this point. Hudson's Bay Oil and Gas in 1969 for the first time paid income taxes because we have these more liberal write-off provisions, but we have not earned an outrageous rate of return. This is a popular misconception.

I agree with you that perhaps depletion is a bad word. If we could get rid of it and use a lower rate of tax as you suggest it might be one solution.

Senator Phillips (Rigaud): I have made the point before that the Government should be courageous enough to introduce such a system and the natural resource industry should make the public aware that if we want our country to expand and to push our frontiers northward and enrich our country in terms of realizable resources, we have to face the basic issue of paying tax for incentives.

The Chairman: Senator Phillips, if we analyse the proposal on which you have tested Mr. Mair, it would mean that all the money actually spent on exploration and development would still be a deductible item of expense before taxable income is reached.

Senator Phillips (Rigaud): Definitely.

The Chairman: However, the effect of what you have suggested is that there would be a remission of 25 per cent of the corporate tax. Therefore, the benefit to the industry would be 25 per cent of their taxable income.

Senator Phillips (Rigaud): Fifty per cent of the taxable income if there were a 50 per cent rate.

The Chairman: Yes. Depletion is no good to any oil, gas or mining company unless they earn money, because they have nothing to write it off against. As depletion exists now, if entitled you can take the benefit of the depletion allowance, but you cannot carry it forward.

Is that not correct, Mr. Mair?

Mr. Mair: That is true.

The Chairman: So would it not be of great assistance if in connection with any depletion allowance you were able to carry the depletion forward under some system?

Mr. Mair: That is what we would expect to do. By obtaining gross depletion we would get depletion to which we were entitled, regardless of what our net income was and be able to carry that forward.

The Chairman: You mean regardless of whether you had taxable income.

Mr. Mair: Yes.

Mr. Richards: Mr. Chairman, it should be brought out here that we believe that depletion or a form of taxation should be allocated to those companies exploring for natural resources on a perpetual basis. They propose to stay in the natural resource business as long as they profitably can.

The main reason for a tax incentive such as depletion is to encourage and help companies, individuals and organizations that are exploring and endeavouring to find more natural resources.

When you get into the area of saying well, we are going to reduce taxes or something on production revenue, there should and must be some consideration given to the concern or company that has gone out as a one-shot proposition and those who continue to carry on indefinitely or perpetuate themselves in that business.

We get into some pretty fuzzy areas occasionally. Some investors might buy oil reserves in an oil field and leave it at that. However, in a company like ours, which encouragement to continue to risk huge sums of capital to find these oil and gas reserves intends to be in the oil and gas business as long as there is one in Canada, we must have which society and industry needs.

The depletion arrangement is a means to keep us in business continuing that type of activity.

The Chairman: Mr. Richards, when the White Paper agrees with the statement that incentives are necessary in the mining, oil and gas business, are they incentives to the industry generally? How do you reflect it? Should the shareholder not benefit in some fashion in relation to the incentive, as well as the company itself?

Mr. Richards: If the incentives are given to the shareholder's company to go and find this, I think he will benefit. It all relates to the shareholders, and in the final analysis we are all working for the shareholders.

The Chairman: The import of my question was that at present a shareholder of a mining company, depending upon the nature of the mineral, gets a percentage deduction from the

dividends he may receive as a depletion allowance, and the company gets a depletion allowance. Is that right?

Mr. Richards: Yes, sir. You are referring to the 20 per cent arrangement?

The Chairman: No, I am not referring to the tax credit. If I have shares in a mining company, depending on the mineral, and I receive a dividend, I may deduct depletion allowance before I account for taxes. Then I am also entitled on the net amount to claim a tax credit. All I am trying to put forward is the position of the shareholder at this moment. If we go along with the suggestion you have made, there would be no depletion allowance to the shareholder directly.

Mr. Richards: Not necessarily. I was not proposing to get into the details of how depletion would be distributed between the corporation and the shareholders.

The Chairman: There would not be any real benefit, would there, to the shareholder under integration, under the depletion that you are proposing, because it would reduce the corporate tax.

Mr. Richards: I would like Mr. Mair to discuss the intricacies of any depletion arrangement.

Mr. Mair: First of all, we would dispute the fact that we should have integration at all. We make our proposals for depletion on the assumption that we would have no integration, because we point out in our brief and show by example that integration takes away all this incentive that has been provided to the company.

The Chairman: Why should not the shareholder get a direct incentive such as he does now?

Mr. Mair: I would agree that he should get an incentive.

The Chairman: Well, how do you interest the capital market in investing in the kind of risk venture that the mining industry and the oil and gas industries offer? Is it not by incentive?

Mr. Mair: It should be by incentives, and that is why we would suggest that we get this incentive in the company, that it be passed on through to the shareholder, and that it not be taken away by some system such as integration.

The Chairman: For instance, at the present time one-third of the net production income goes as an incentive to the oil company. But what about the shareholder? Are you proposing that it would be equitable to take some part of that one-third and pass it on to the shareholder?

Mr. Mair: I would think that it is equitable to do so.

The Chairman: By what method would you do that and avoid it being income in the hands of the shareholder?

Mr. Mair: Oh, effectively you would be giving the company a benefit to earn a higher rate of return, and therefore the shareholder would get that benefit. By passing it through, we are suggesting that there should be no integration, but there should be varying rates of dividend tax credit, similar to the system we now have in effect.

The Chairman: That means there will be a direct depletion allowance to the shareholder?

Mr. Mair: A direct credit to the shareholder, yes.

The Chairman: Has not the format for interesting capital, whether for equity financing or debt financing, in the mining and oil and gas industries always been on the two prongs of tax holiday and depletion allowance?

Mr. Mair: Those have been the two main incentives.

The Chairman: If you say that the capital you get has to come mainly from sources outside of Canada, this is what they have grown up on?

Mr. Mair: That is true.

The Chairman: This is what they know; they have been educated to know and understand how it works. Would it not be most likely that there would be a withdrawal of capital if these incentives were changed?

Mr. Mair: Yes. We believe that if the incentives are changed or if the White Paper is implemented, it would accentuate the amount of foreign ownership in resource industries.

The Chairman: Are there any other questions on the subject of incentives?

Senator Molson: In the form that is now proposed, particularly in the White Paper and

the way we are discussing it, is the term "depletion" really applicable? You are not really getting a relief for a wasting asset. This is really now an incentive, and the word "depletion" is probably almost out of place in this context, is it not, Mr. Mair?

Mr. Mair: Yes, I think so. In fact, I have heard the White Paper described as not a depletion at all any more. Perhaps it would be an advantage, as Senator Phillips mentioned, to get away from the word "depletion".

Senator Molson: That is what I was going to tie it in with, because in effect what Senator Phillips has suggested is really more realistic than using the term "depletion" for something that is not a depletion allowance, but is in fact a resource development incentive.

Mr. Mair: That is true. That could be a very effective and simple way of doing this if it is a saleable product; that is, if you can sell that to the public it would be a much more effective and simple calculation to use as an incentive.

Senator Phillips (Rigaud): In a prior hearing, Mr. Chairman, you will remember that Senator Molson pointed out that public opinion does not like to associate our natural resource industry with what he called, without meaning to hurt people south of the border to us, "the Texas millionaires", who do not pay too much tax. I think we are attempting, in our thinking at least, to meet that climate of being fair to the natural resource industries, but at the same time trying to equate it with the concept of justice and equity, and what we think may be a legitimate area of complaint, within a restricted area. May I put another question?

The Chairman: Yes.

Senator Phillips (Rigaud): I refer you to section 25 of your brief.

Senator Burchill: Are you leaving the subject of depletion?

Senator Phillips (Rigaud): No, it is related to it from the point of view of incentives. I think we are still on the subject. On page 25, in paragraph 4 you say:

> The new foreign capital that will continue to be needed in Canada is extremely fluid and therefore quite sensitive to the recipient country's environment. HBOG. . .

That is your company, of course,

> . . . is concerned that the international community will not maintain its favourable view of the economic and social climate in Canada.

Is a fair inference to be drawn from that observation that in your view the savings of the Canadian public needed for all segments for expansion would not be sufficient to meet the needs of expansion of the natural resource industries?

Mr. Mair: That is right.

Senator Phillips (Rigaud): And therefore the view of foreign investors must be taken into consideration in dealing with the subject matter of the White Paper?

Mr. Mair: I would say so, yes. An estimate of the requirements for capital in the oil industry in the 1970s is approximately $20 billion, largely for northern and offshore development.

Senator Phillips (Rigaud): Per annum?

Mr. Mair: No, this is a total, $20 billion. We feel that Canada cannot provide that much capital, and we will continue to need foreign capital to help develop our resources.

Senator Phillips (Rigaud): If the Chairman will allow me as a corollary of my question and your answer, may I ask: do you feel that the publication of the White Paper, even though it was a chart and not a letter of intent of government policy, has had the effect of slowing down the interest of foreigners in investment in our natural resource industries? We have not had to check the pulse of the market as a company. In talking to people in New York who have capital, I feel there is a considerable amount of distrust of the Canadian tax situation. They are not sure what will happen, and there has been some nervousness about coming to Canada.

Senator Phillips (Rigaud): Specifically, if we did implement the provisions of the White Paper by way of an integration plan and if we implemented the suggestions on the natural resources industries, is it your view, and that of your company, that the economic consequences from the point of view of expansion of the natural resources industries, if not serious or great, will be very troublesome?

Mr. Mair: There is bound to be some effect from it because people would, with the type

of legislation proposed in the White Paper, not see as good a rate of return as they do even under our existing tax law, and therefore there would be some capital which would not be coming into Canada.

Senator Phillips (Rigaud): One natural resource company took the position that if the White Paper were implemented it would result in a loss of some 38 or 40 per cent of its intrinsic value. Do you consider that too high?

Mr. Mair: I would not like to say.

The Chairman: It is obvious that if capital is not available to the extent you require for expansion, you have to cut down on expansion. You cut down on expansion and you cut down on earnings.

Senator Burchill: I am concerned with Senator Molson's suggestion of a few minutes ago that depletion is not regarded and does not actually represent a wasting of a natural product. I think the investing public regard it as representative of a wasting product. Is that statement not correct? Some companies have different rates of depletion. We should recognize this because I think it is very important.

Senator Benidickson: It seems to be a bit of a misnomer in certain circumstances, such as Senator Molson outlined.

Senator Molson: What I said was that in the form in which it is now appearing and which we are now discussing, and as suggested in the White Paper, it seems to be a misnomer.

The Chairman: It negates the basic meaning of depreciation.

Senator Molson: Exactly. I am not trying to change the meaning of the word "depletion". I am merely saying that the word is not really applicable to what we are discussing.

The Chairman: Yet depletion in the United States tax laws is still defined in terms of replacing the wastage of property.

Senator Benidickson: Is it not a misnomer also when the White Paper proposes that any benefit of this kind, when it is tied in with future exploration, is anti-waste or depletion.

The Chairman: Are there any other questions on this depletion aspect? If not, may we move on to another subject. I take it that we do not need to spend much time on the discussion of integration. You are against it?

Mr. Mair: We are against it.

The Chairman: Against it is because of the effect on the shareholders of your company in the form of which it is put forward.

Mr. Mair: Not only because it virtually eliminates the depletion allowance which the companies receive, but I would think for any company that this integration proposal is very complicated. I am sure you have received copies of a document comprising about 15 or 20 pages which describes how integration would work with one single type of capital. If you considered a company that might have three or four capital issues and with various classes of preferred, and then tried to work that out you would need several hundred pages to describe how to report it to your shareholders—what this creditable tax is. I think the whole procedure is not only too complex, but it defeats some of the very purposes which the White Paper proposes to offer.

The Chairman: You support the continuance of the present tax credit?

Mr. Mair: Yes, and if they want the same results they can do so by varying the amount of tax credit.

The Chairman: Which way?

Mr. Mair: Either way. One of the points they make is that the tax credit is not as useful or as important to a low income person. If that is true they can vary that by increasing the dividend tax credit for the low income group and reducing it or leaving it at the 20 per cent level for the higher income group.

The Chairman: You realize that the proposed integration will produce a loss of tax revenue of about $230 million? If you had a choice between bringing in integration and facing a loss of revenue of $230 million and not bringing in integration, and maybe lowering the individual tax rates in that area where they are substantially increased, which one would you lean toward?

Mr. Mair: I would take the second. I am still opposed to integration.

Senator Molson: Mr. Mair, do you agree with the view which has been expressed here more than once in the committee that the proposals contained in the White Paper are going to create real difficulties, both for the individual in Canada and for the corporate

taxpayer, in compiling and making the returns which will be required? Is it your view that the complexity will greatly increase?

Mr. Mair: That is one of the points we have made. All we would be doing if we implemented the White Paper would be to impose a very complex system. I doubt if anyone today would know how some of its proposals could be worked out, considering there are several classes of capital.

An example we might use would be Hudson's Bay Oil and Gas Company. You will note that about 66 per cent of our stock is owned by Continental Oil. The creditable tax is no good to them. We could declare a dividend to them one day and we would not use up any of our creditable tax. The next day we could declare the dividend to Canadian shareholders and be able to use all of the creditable tax we had for the small number of shareholders. It is that sort of problem.

The Chairman: You would certainly need different classes of shares.

Mr. Mair: We could do that.

Senator Phillips (Rigaud): As you said, Mr. Chairman, we have probably covered the question of incentives for natural resources. I would like to move over to capital gains on the assumption that again we bury the corpse of integration honourably with proper ritual and deal with the possible introduction of a capital gains tax as part of our present Income Tax Act—meaning by that in addition thereto. We have had all sorts of suggestions on the nature of a capital gains tax. The common consensus seems to be that we should have either a flat rate of 25 per cent by putting it in a separate category or escalating it upward so that at no time it should exceed 25 per cent. On the other hand, we have been having considerable trouble and variations of opinion on the determination of the exempted aspect of a capital gains tax, ranging from homes, assets up to $5,000 and so on. We have had the suggestion that in the earlier stages of the introduction of the capital gains tax in our country, it being young, that we should not necessarily follow the American practice and that we should merely introduce a capital gains tax applicable to the profits made and the profit on sales of securities only. Would you be good enough, Mr. Mair, to develop the thinking of yourself and your company on that for our guidance?

Mr. Mair: As you know, we have recommended, too, that we should not have higher than 25 per cent capital gains tax and that we should exempt unrealized gains, gains from the sale of homes and that sort of thing. However, I think that to have a tax system, it is reasonable to look at securities. I am thinking of land speculation and that type of thing. I believe that when people make a gain of that sort, although there should be some tax on it, because of having taken a risk in getting into these ventures, I think it should be at a lower than normal rate.

The Chairman: Mr. Mair, you know that land sales, which are in the nature of venture in the nature of trade, are presently taxable?

Mr. Mair: In almost all cases, yes, Mr. Chairman.

Senator Beaubien: At the full rate.

Mr. Mair: I would suggest that capital gains be taxed at a somewhat lesser rate, because they are taking a risk.

The Chairman: There is one thing I have not been able to get clear in my own mind in regard to the White Paper on this question. When we propose a capital gains it may well be that, to the extent that the law has developed and put a tax on a lot of transactions that once were regarded as capital gains, into the income category—that is where they will stay, under the White Paper—so that there is going to be some problem in dealing with capital gains—I mean, capital gains as such. We come again to the statement of misnomer which may be possible, if you call capital gains income. It seems to me that there may be a contradiction in terms. What they are saying is that people know this is a capital gain but we are making this income, rewriting the dictionary.

Senator Connolly (Ottawa West): *Ipso verbi*, by the word itself.

Senator Hays: Can you tell me how much money the Hudson's Bay Oil Company has made on capital gains?

Mr. Mair: That is a difficult question, Senator Hays. We have made capital gains on the sale of shares of some pipelines we invested in. In order to get a pipeline started, producing companies generally have to put some equity capital into those pipelines. We have made gains in the past, over many years now, and it would be difficult for me to make an estimate.

Mr. Richards: Senator Hays, it is insignificant in the overall picture.

Senator Hays: So really it is quite all right for you to say that there should be capital gains on land speculation.

Mr. Mair: Any time we have had anything like that, we have already paid tax. It has become part of our taxable income.

Senator Hays: There is one other thing I would like to ask. You made a statement, Mr. Mair, that you paid income tax for the first time in 1969?

Mr. Mair: Right.

Senator Hays: It seems to me that this leaves the impression, to a lot of people, that the Hudson's Bay Oil Company has paid no income tax. But you have a great labour content in your business and these people paid a great deal of income tax. Therefore, I think that in asserting "no tax payable until 1969", probably you should indicate how much income tax the people employed, and so on, have paid.

Mr. Mair: Yes, I would like to go further than that, Senator Hays, and refer you to Exhibit 1 on page 2, and point out the amount of other kinds of taxes that were paid as well as income taxes and contributions to govarnments in various forms—mineral tax, conservation board taxes, property tax, real estate and business taxes. These come to a total of $107 million over the past fifteen years. In addition to that, we have contributed other amounts, too.

Senator Connolly (Ottawa West): You paid also a lot of consumption tax, too.

Mr. Mair: That is right, a lot of sales tax. So the company has paid and made contributions to governments, $148 million in taxes. In addition to that—this would be a very wild statement, I would think—we probably have something in the neighbourhood of $1 million a year paid in taxes by our employees. Of course, in making all expenditures, the secondary industries related to our oil industry pay a lot of taxes, so the industry generates a lot of taxes.

Senator Hays: So, really, by the very fact that you have been in operation over the last fifteen years, you have paid indirectly through this company from $11 million to $12 million a year?

Mr. Mair: That is about what it would average, yes.

Senator Phillips (Rigaud): Plus the distribution, Senator Hays, referred to in Exhibit 1, page 3, which shows the dividends paid to shareholders, $66,215,000. The recipient shareholders also paid taxes.

Mr. Mair: That is true.

Senator Benidickson: Of course, that is true of all taxpayers. If you go to the indirect taxes paid by their employees and consumption taxes, you find yourself including everything, if every taxpayer put forward a statement as to the value of the industry from the point of view of generating taxes other than income tax. Senator Phillips indicated that we have to have some public opinion to support our recommendations. The White Paper, of course, presumably those opposing the White Paper have it in mind, it is in their thoughts, that extractive industries have been treated generously from the point of tax rules. Some think that they have an inadequate appreciation of what the circumstances are and that it is required to be somewhat sympathetic. And we have to face up to this. We have to find some practical way to explain some of these figures. Perhaps you could do so.

When I look at page 32 of your annual statement, where you have a 10-year financial review, somebody might pick up those figures and say they indicate that, after you have paid your employees and paid the normal expenses, you have a net income in the 10 years of something in excess of $150 million, and that, notwithstanding that, over the 10-year period you have only paid about $2 million in income taxes. Out of the difference in excess of $150 million, and the $2 million, out of that, what would be the value of the depletion deductions that help you to avoid paying income taxes at the normal rate of, on the amount in excess of 50 per cent?

Mr. Mair: It is a very small amount, senator, because during all that period we had no benefit from depletion allowances. Since we were not in a taxable position we did not claim any depletion until 1969, at which time we claimed about half a million dollars.

Senator Benidickson: Notwithstanding the fact that you used depletion for the first time in 1969, that was also the first year in which you paid income taxes.

Mr. Mair: That is true.

Senator Benidickson: In fairness to you, I note that in the same statement it is indicated that while you have had a net income in excess of $150 million, you have also over those same ten years been putting out further investments and further capital expenditures on exploration and development amounting to $385 million. You should get credit for that continuing investment, which has the effect of creating jobs and so on.

Mr. Mair: It was this expansion and continued investment which kept up from being taxable. The money we spent in that respect was deducted from the earnings to keep us from being taxable.

Senator Connolly (Ottawa West): Mr. Mair, your product has to meet international competition.

Mr. Mair: Yes, it does.

Senator Connolly (Ottawa West): Your annual estimates now show a substantial taxable income and a fairly substantial net profit; in other words, a fairly substantial cash flow. Is cash flow the main standard which should be looked at in determining the rate of taxes you pay?

Mr. Mair: I think not. Cash flow in itself gives no recognition to the fact that huge amounts to money have been invested in capital assets. Hudson's Bay Oil and Gas, as an example, is one of the larger producers of natural gas. It has gas plants, and in each year of the last ten years we have made large investments in natural gas plants. To give recognition to the fact that we have spent that, tax flow is not what you should look at in terms of tax. You must give some effect to the write-off, the depletion for these big investments in capital assets.

Senator Connolly (Ottawa West): What is your effective rate of tax at the present time, and what would it be under the White Paper? In your calculations would you please include provincial taxes by way of royalties and so on? A rough estimate is all I want.

Mr. Mair: It is difficult to answer that question directly. In 1969 we do show a tax figure of approximately $2.4 million, which seems to be a relatively low rate. But that was the first year in which we became taxable and we had a carry-forward of expenses into that year. The rate will double or triple in 1970 without our income going up appreciably.

Senator Connolly (Ottawa West): So even under the present system your tax rate would go up.

Mr. Mair: Yes.

Senator Connolly (Ottawa West): Have you any estimate of that?

Mr. Mair: Our over-all effective tax rate would be in the range of 45 per cent—that is, income taxes together with other royalties paid and property and sales taxes and all the other taxes. Under the White Paper it would be increased because we would reduce the amount of depletion we have, depending on how much exploration and development we do. It would be over 50 per cent under the White Paper. If we can rely on the rates given in the White Paper, it should not be much over the 50 per cent mark. However, we doubt that that rate would be held.

Senator Connolly (Ottawa West): What does that increase in rate do to your competitive position and to your cost picture?

Mr. Mair: Selling oil is a competitive business. We have no control over the sales price. Therefore we would not be able to pass on any of the increased tax. Therefore, the amount of money available for exploration would be reduced because exploration is the first discretionary expense that we have. Exploration is the first thing that would suffer from an increased tax payment.

Senator Connolly (Ottawa West): Would there be an effective increase in your competitive position as a result of the increase in tax? Although I refer to your company, my question really applies to the industry as a whole.

Mr. Richards: Senator, is your question directed to competition with respect to other Canadian oil companies or oil operations in the rest of the world?

Senator Connolly (Ottawa West): What would be the competitive position under the White Paper for a Canadian producer selling in the world market?

Mr. Richards: He would be placed at a very competitive disadvantage. In fact, he is today as things now stand. The Canadian producer is competitive so far as the United States is concerned but he is not competitive with the Middle East producers and with some other producers in other parts of the world. The reason is that those other produc-

ers have bigger, fatter reserves from which to produce.

Senator Connolly (Ottawa West): Have they better tax rates, too?

Mr. Richards: I am not intimately familiar with the tax rates because each country has a different rate.

The Chairman: But they have lower costs.

Mr. Richards: Their costs are so low that it is just hard to compete with them.

Senator Connolly (Ottawa West): Their labour costs are cheaper.

Mr. Richards: Their labour costs are cheaper and they can produce thousands of barrels per day per well, whereas we produce in the hundreds of barrels.

Senator Connolly (Ottawa West): In other words, merely to look at your cash flow, at your net profit and at your taxable income and to say that you are doing well and therefore the taxes can go up is a very unfair and a very damaging kind of approach to the oil industry generally.

Mr. Richards: It definitely would be damaging, because the final test is—what is the rate of return you are achieving on the investment in the petroleum industry? As Mr. Mair mentioned, it is much below many manufacturing and other industries in Canada and on this continent generally. We are able to attract capital now because of the expectation of greater returns in the future. If our returns go any lower, we cannot attract the capital and as you know, the oil and gas industry is very capital intensive. We just cannot get the money.

Senator Connolly (Ottawa West): I am concerned that in some respects the approach of the White Paper is that because there is bigness involved, particularly bigness in net return or net income, if you like, or taxable income, that you can take more tax. I think it seems to me from what you said that in the competitive market in which you must operate, the test is not how much money you make, but is rather can you compete and will these added costs which result in increased taxes put your product out of competition.

Mr. Mair: We would still sell our product, but the effect is that it would reduce our rate of return, and we are not able to compete in the money markets, or, to put it in another way, we are not able to compete with the capital from other countries.

Mr. Richards: To be more blunt, we would sell the product we have now in inventory, such as crude oil and gas reserves, but we certainly could not carry on the intensive effort that we have carried on in the past to find more of those products to sell at a cheaper price.

Senator Hays: There is one point which the general public probably is not familiar with. Now it may be in your statement, but I have not gone through the statement. They say that the amount of money that you return to governments, particularly the Alberta Government where their total revenue is at times up to 42 per cent of the money required in the total budget, was received from the oil industry in the purchase of land. And with a 12½ per cent royalty, if you retire from exploration and that sort of thing—do you have a breakdown on the amount of money you have paid to the province in royalties and in the purchase of land because even if you drill a dry hole, you still purchase the land.

Mr. Richards: Yes, sir.

Mr. Mair: We have a breakdown, Senator Hays, in exhibit 1, and particularly if you go to page 4 of exhibit 1 you will see that in the 15-year period we have paid to governments for that kind of thing, bonus costs and so on, a total of $148 million.

Senator Hays: Then there is the continuing amount you pay in the form of royalties as you get production.

Mr. Mair: That also is given in exhibit 4. The amount we paid in royalties and rentals on this land after we have it.

Senator Benidickson: Is that considered as capital or an expense before calculation of net income?

Mr. Mair: The royalties and the rentals are all considered expense. In 1969 we paid $7.6 million in Crown royalties.

Senator Benidickson: Then it is a form of taxation.

Mr. Mair: This is almost a form of taxation.

Mr. Richards: Senator Hays, in that respect I think the framers of the White Paper overlooked one important point. They see the advantages the western provinces have

enjoyed from the oil industry and I assume that they thought that the entire population of the rest of Canada had not enjoyed those advantages so that the way to distribute more of the wealth would be through higher taxes for the oil companies. Now I should bring to your attention the fact that the oil industry is now expanding in great strides beyond the western provinces, with more and more activities and related to that, hundreds of millions of dollars are now being expended in the Northwest Territories, the Arctic islands, and the east and west offshore areas on federal lands. Now we assume that there will be some success there. We would not be out there if we did not think it had great geological potential. These figures which you see which represent contributions to the economies of the western provinces can very well be multiplied many times in respect to federally-owned lands and activities on federal lands. That will come in the future. The stage is being set now, and I am confident that great discoveries will be made.

Senator Connolly (Ottawa West): Would you repeat that last statement.

Mr. Richards: I am confident that there will be big and important discoveries of reserves, oil and gas reserves, made on federal lands. The federal Government would then enjoy royalties, rentals and probably bonuses from land sales. They have enjoyed some to this day, but once you have found the hydrocarbons in commercial quantities, the price of the game goes up and the land becomes much more valuable and brings a bigger price. So the same type of moneys that have gone into provincial coffers will surely go into the federal coffers in the future.

Senator Hays: Further to that, the people of Canada do enjoy this through equalization payments. Alberta was never a have province until the discovery of oil there. It was after this that we became a have province.

Mr. Richards: Another thing that is overlooked when the oil industry is identified as a western operation is the fact that practically all the supplies and equipment used out there, which amounts to many, many millions of dollars, are purchased in eastern Canada, the manufacturing centres. Certainly that impact on the economy is felt clear across Canada and in every province.

Senator Connolly (Ottawa West): You talked about the importance of prospecting in the north, and I would take it from what material we have seen before this committee that there is a good deal of interest in offshore activities on both coasts?

Mr. Richards: There definitely is.

Senator Connolly (Ottawa West): And this is all federal land even though the provinces in some cases are issuing permits. The Supreme Court decision did say it was federal property, and perhaps that will stick. But, in your opinion, will the provisions of the White Paper inhibit or enhance that kind of development in the north and offshore both east and west?

Mr. Richards: There is no doubt that if the proposals of the White Paper become law, together with the regulations, it will inhibit further extensive exploratory and development work in these remote and frontier areas. I can assure you of that.

Senator Connolly (Ottawa West): Mainly because of the depletion in the other areas?

Mr. Richards: That is one facet of it.

Senator Connolly (Ottawa West): Is it an important facet?

Mr. Richards: It is a very important facet.

Senator Connolly (Ottawa West): Is it the important facet?

Mr. Richards: There are other aspects to this, but that is an important one.

The Chairman: Now, that is enough. Don't push too far.

Mr. Mair: I think the loss of the incentives through integration might be the important facet because it does lower the rate of return on the investment.

Senator Phillips (Rigaud): How long did Mr. Richards say he had been in the oil industry?

Mr. Richards: I have been in the oil industry 37 years, and I am going into my twenty-third year with Hudson's Bay Oil and Gas.

Senator Phillips (Rigaud): I would say that is a rather important statement.

Mr. Richards: I have participated in the growth of this company from the time when it had zero barrels of production, and you see from our annual report what it has built up to now.

I think I should explain, gentlemen, that I have been chief executive officer and presi-

dent of this company. I have been a geophysicist with it and my background is exploration, but I have been professional manager for a number of years. I look at the overall impact on the industry and the Canadian economy of these White Paper proposals. Certainly, I am not adequate and disciplined to talk to many of the details, but I can assure you that through experience I have a pretty strong feeling of what these proposals will do to our industry and the overall economy, and that is important.

The Chairman: Mr. Richards and Mr. Mair, are there any other points. You have developed a number of points on the White Paper. We have been picking at what we think you regard as the major points, and your position on some of the other matters like principal residents, etcetera. These are obvious things. Is there any other item or subject matter you would like to bring forward?

Mr. Mair: I think most of the items are covered in the submission. However, yesterday I had the benefit of listening to some of your discussions with other groups, and one point that was raised was with respect to small businesses. Of course, we are not concerned with such provisions in relation to the Hudson's Bay Oil and Gas because that is a relatively minor figure in our tax calculations, but many of our suppliers and people we deal with are in this category.

Since writing this submission I have been thinking about some way this might be handled, and I would like to try that out on you people, if I might. That is that every small business would calculate its income tax at the 50 per cent rate, would pay only 21 per cent and the balance would be set up as a liability on its balance sheet. As long as it did not pay any money out to its shareholders, it would not have to pay this additional 29 per cent, but before they could start withdrawing dividends from the business the company would have to pay the balance of that 29 per cent. This would give the company the benefit of building up capital and it could retain this money and use it in the business until they reached some limit. Perhaps we might set that limit at $100,000 of tax liability, and at that point they would have to start paying full rates, from there on.

The Chairman: Tax liability or net profit?

Mr. Mair: No, I am speaking of the tax liability. For example, if a business had an income of $10,000 in a year they would calculate their tax as being $5,000 and they would only pay 21 per cent, or $2,100, and set up tax liability of $2,900.

Senator Phillips (Rigaud): Would the deferred tax pay any interest in favour of the Crown, and would the total deferred tax be exigible notwithstanding the modest amount of dividends that would be declared?

Mr. Mair: I would propose that they would not bear interest in favour of the Crown. This would be just a deferred payment for the benefit of the company, but before they started paying dividends to themselves they would have to pay 29 per cent on any of the amount they would propose to withdraw.

Senator Phillips (Rigaud): Oh, I see. That was not made clear by your statement.

The Chairman: If you compare that proposal with what we have been talking about—that is, a straight 21 per cent tax, where a small business is defined as having, say, a net profit of $75,000 or $100,000 and they pay 21 per cent on the first $35,000—at least, when they have done that they have limited their liability and their hands are free later on if the proprietor, if it is a family operation, is getting older and he wants to step out, or if it becomes an estate where there is the problem of transfers then. Would the tax liability fall in at that time to embarrass them? There are so many situations you have to cover, once you start out with deferred tax liability, that you do not have to cover in the situation we have been talking about and the plan we have been discussing.

Mr. Mair: That is true, but it does get away from that disadvantage of deciding what a small company is. If you relate the size of profits to define a small company, then Hudson's Bay Oil and Gas might have a profit of $25,000 some year.

Senator Phillips (Rigaud): In that unfortunate circumstance you would be entitled to the concession.

Mr. Mair: Thank you.

The Chairman: Are there any other points?

Mr. Mair: No.

The Chairman: Mr. Richards?

Mr. Richards: I think just one point should be brought out again. It has been brought out in other submissions to this committee. That is the impact that, I believe they call it, inte-

gration of taxes would have on a company such as ours that ploughed back a great percentage of its earnings into the business. We need that money in order to carry on, to expand our efforts, particularly our efforts to find new oil and gas reserves. Under the proposals contained in the White Paper, we would be under heavy pressure, as would many other companies, to distribute all our earnings to the shareholders. That would have a very adverse effect on the type of industry we are operating, as we need it in the business. In the past the shareholders have been quite happy for us to try to expand and take advantage of the opportunity to find more oil and gas reserves in Canada, and to use the earnings for that purpose instead of distributing them to the shareholders. I believe that is a very important matter to consider.

The Chairman: Thank you very much, Mr. Richards.

Mr. Richards: We appreciate very much the allocation of your time and the time of this committee. We know that much of this is repetitive; you hear the same story; but I think it gives you an idea of the overall concern of the industry and individual companies.

The Chairman: Honourable senators, the next submission is that of Aquitaine Petroleum Company, and we have Mr. A. Dumestre and Mr. Neil Phillips here. Mr. Phillips is going to make the opening statement.

Mr. Neil Phillips, Q.C., Counsel, Aquitaine Company of Canada Limited: Mr. Chairman, this is a presentation by the Aquitaine Company of Canada Ltd., Société Aquitaine du Canada Ltée, which is a petroleum company, an oil business, searching for and developing oil properties. However, the presentation today is not in its capacity as an oil company, on which it is not making any specific presentation, but rather in its quality of being a widely-held Canadian corporation controlled by a foreign shareholder. We have prepared a brief, the first two pages of which give a short history of the company. Mr. Dumestre, the Vice President (Exploration), is here should any members of the committee care to question him on any of the business aspects of the company. I shall, in my capacity as director and general counsel, try to answer any other questions that might be put. If I may I will direct the attention of honourable senators to page 3 of the brief which sets forth the four categories in which the submission is being made.

The first one is the objection to the application of the capital gains tax to Aquitaine's parent company, Société Nationale des Petroles d'Aquitaine, should it sell any of its common shares in this company, Aquitaine. This refers to paragraph 6.47 of the White Paper.

The second is the application of the five year revaluation rule to the holdings of SNPA in Aquitaine.

The third is the taxing of unrealized capital gains when employees and persons of that calibre who have come from France, and who have set up temporary residence here, leave Canada.

Finally there is a comment, if this committee wishes it, on the apprehensions concerning integration in so far as it applies to distributions to non-resident shareholders.

With your permission, Mr. Chairman, I shall not deal with the second and third items, namely, the five year revaluation rule and the taxing of unrealized capital gains of employee-type of taxpayers, because these have been covered by other submissions at considerable length. Unless the committee otherwise wishes it, I shall not make any comment on those points, and shall leave the brief to speak for itself.

I would also put in a secondary category, in the interests of time, the last point on the effect on non-residents of the integration proposal, although that does have some very interesting wrinkles. With the permission of the committee, however, I would like to deal at a little more length with the first point, which is far and above the most important point in so far as this company is concerned.

The Chairman: This is on page 4?

Mr. Phillips: Yes, commencing at page 4. If I may I will refer to the comments that were made in the previous brief presented this morning. This one aspect of the White Paper has an enormous effect on the desire of foreign investors to invest in Canada, and I repeat that we are presenting these items not because we are an oil company. This applies to every widely-held Canadian corporation where more than 25 per cent of the capital stock is owned by non-residents, and to all holders of foreign stock where it is a closely-held Canadian corporation.

I had hoped to be able to summarize this, but having regard to its nature, and since I am limiting it to a relatively few pages, I think I might just read the brief from page 4 to the bottom of page 7, where this matter is set forth in a better way than I can summarize it.

The company strongly objects to the provisions of the last sentence of paragraph 6.47, which would impose a capital gains tax upon its parent shareholder, SNPA, should it at any time or from time to time sell the whole or any part of its common shares of the company.

I might add there that this would apply even if the shares were sold by SNPA, a non-resident of Canada, to another non-resident of Canada. If absolutely nothing took place in Canada, a capital gains tax would be imposed upon the foreign shareholder. I shall come in a moment to the question of whether it is collectible or not, but technically it is imposable.

The proposal to tax capital gains of non-resident shareholders, even where, in the case of widely-held corporations, it is limited to non-residents who are selling shares out of a substantial interest, is inconsistent with generally accepted international tax principles and practices.

To our knowledge—and we have tried to research this—West Germany and the Netherlands have attempted this. Although it is difficult to get any real concrete figures, apparently it has been a pretty unhappy situation. They have had to abandon it in many of their treaties, and the tax has become virtually uncollectible in other cases.

Neither the United States nor the United Kingdom imposes capital gains tax on foreign shareholders as such, and it appears to the company that Canada's position in the international investing community would not be improved by the imposition of such a taxing system.

I think I can perhaps skip some of the reasons beyond that.

The proposed tax of paragraph 6.47 of the White Paper—and we might add, although it does not apply directly to this company, paragraph 6.46 which has an even more onerous application to closely-held Canadian corporations—discriminates seriously against foreign shareholders of Canadian companies as compared to their Canadian counterparts. The impact of the proposed capital gains tax on Canadian shareholders can, in many instances, be reduced by dividends in cash or stock carrying with them substantial tax credits, so that there is no resultant tax. Since, however, the proposed dividend credits of the White Paper are not to apply to non-resident shareholders—paragraphs 4.49 and 4.50—and in addition withholding tax on dividends to non-residents is to continue to be applied, foreign shareholders of Canadian companies will not only be unable to use the same relief procedures for capital gains as are given to Canadian shareholders, but in addition, may be taxed in their country of residence or domicile on such distributed receipts without equivalent offsetting tax credits.

Perhaps I might move on through some of this more detailed material. I might add, as a matter of interest to the committee, that in France where the parent company of Aquitaine resides there is no capital gains tax on individuals, and only a 10 per cent tax on the capital gains of corporations.

Now, the company found itself in a difficult position in dealing with the question of tax avoidance. It is perfectly obvious, gentlemen, that to attempt to impose a tax on non-resident shareholders where they are selling, say, to other non-residents, or even where they are selling through brokers abroad, is effectively uncollectible unless voluntarily the foreign entity agrees to be bound by Canadian law. Most of the time, by the simple procedure of coverting to bearer shares or street shares, and things like that, it would be absolutely impossible to find out when a foreign company controlling a publicly-held Canadian company does or does not sell portions of its interest, and there may be inter-corporate relationships. This type of tax which would be imposed only by Canada and perhaps, as I said, two or three other small western countries, would put those companies that would abide by the law in a very bad competitive position vis-à-vis, let us say, the United States and the United Kingdom, and most other countries for that matter.

It is, therefore, the submission of this company that on the whole the international tax rule should be followed, and the proposal of the White Paper eliminated, namely, that no tax should be imposed upon foreigners for trading in securities of either publicly-held or closely-held foreign corporations, except possibly—and we say this—if they have a permanent establishment in Canada and are trading in securities through a permanent establishment in Canada, because in those circum-

stances they are carrying on a Canadian business and they should be taxed in the same way as everybody else. But, in the normal, conventional sense of the term, a foreign corporation should not be taxed on its securities transactions in Canadian companies unless it has some closer connection to Canada than that of merely being a shareholder.

The Chairman: Aquitaine is a Canadian company, is it not?

Mr. Phillips: Yes, Aquitaine is a Canadian company.

The Chairman: And it carries on business in Canada?

Mr. Phillips: Yes, it carries on business in Canada.

Senator Isnor: What percentage of the shares are held in other countries?

Mr. Phillips: Well, it is difficult to say, sir, but 82.4 per cent of the shares in the company are held by its parent company SNPA. There was a public issue in 1969 in both the United States and Canada. The shares are listed on the American stock exchange. We do not have the exact figures at the moment of how many shares of Aquitaine Company of Canada are held by U.S. shareholders. We can tell you that more than 82.4 per cent of the company is held by non-residents, because that is the French holding.

The Chairman: I assume Aquitaine has transfer offices outside Canada?

Mr. Phillips: I believe it does, sir. The integration point, gentlemen, is one of some importance, if we assume that integration is still a live subject.

The Chairman: Well, for purposes of your presentation, let us assume that.

Senator Molson: It is certainly alive until it is killed.

The Chairman: That is right.

Mr. Phillips: We should make a comparison with the French law, which has some type of integration procedure. It is not at all like the system proposed by the White Paper, but it does have a system which passes on to the shareholders certain tax benefits which they can take as a credit against their dividend receipts.

In France, however, it is not based on the taxes paid by the company as such. They can pay supplementary amounts. In order to free dividends every shareholder gets the tax credit as though the company had paid the full tax. If a French company has not paid tax, it has to pay what is known as précompte, which brings it up to an equivalent tax level.

I do want to bring to the attention of the committee the experience of France with foreign companies. When the French enacted this procedure they took much the same position as the White Paper. They gave the tax credit provision to domestic shareholders but not to foreigners.

The net result was that virtually no other countries accepted this position on the part of France and would not negotiate treaties on this basis. The prime leader of the objection to this system was West Germany. By negotiation with France, they, shall we say, convinced the French Government, with the result that they had to give up all withholding taxes on dividends to West Germany. In addition, they had to agree to a situation whereby West Germany would give its taxpayers who received dividends from French companies the same credit as though those taxpayers had been domiciled in France.

In other words, West Germany reduced its tax collection by giving a credit to those shareholder taxpayers for the French taxes paid. This was equated by an intergovernmental payment by France to West Germany to supplement the loss to the West German Government caused by the granting of such credit.

Senator Benidickson: They did it that way rather than change their law requiring a non-resident to pay tax.

Mr. Phillips: That is right. When the White Paper, somewhat cavalierly, says that will not give these grossing-up credits to non-resident shareholders and will re-negotiate treaties it is, respectfully, in the light of experience just not in accord with the international tax community.

The United States followed West Germany in this arrangement. I believe since January 1970 the French have literally abandoned their attempts to convince any foreign countries. They have told all of them that will enter into treaties that they will eliminate their withholding tax. In addition they will repay their loss as a subvention payment if they give the tax credit to their taxpayers investing in French companies.

I cannot tell you what it would mean in loss of revenues to Canada if following this integration proposal Canada was forced into giving the same types of benefits to foreign countries as the French were.

Senator Benidickson: Particularly on a tax agreement with the United States.

Mr. Phillips: That is right. Considering the huge foreign investment in this country compared to that in France, one cannot accept the figures of the White Paper on the assumption that Canada will not be forced into some sort of an equivalent corner when negotiating its tax treaties.

We thought that as a company, and a Canadian company, we should bring this point to the attention of the committee because of our connection with France and therefore our knowledge, indirectly, of what happened there when an integration system was tried.

The Chairman: How badly would you say Canada needs a tax treaty with France?

Mr. Phillips: I cannot tell you how badly we need it. We certainly have many major companies now which have large investments in Canada. This company itself represents a huge investment. There is the Elf Oil Company, which is an affiliate, one might say, of this. There are many large companies which we hope will be attracted to Canada from France.

The question here is not France, but if the integration system is implemented every foreign country will say, if you are giving grossing-up tax credits to your domestic shareholders we want them for our people.

That is the experience of one other country that tried to do what the White Paper tries to do.

Senator Benidickson: In addition to that you are saying that in negotiating some of these tax treaties France has been obliged to give credits for the withholding tax.

Mr. Phillips: That is right. I can only tell you that the results were that they abandoned the withholding tax. Whether or not this is part of the *quid pro quo* of this point, it occurred at the same time. Should the committee wish, I can check this.

I believe that the French first gave up the withholding tax in an attempt to stop at that point. Subsequently they had to give the subvention payment to the foreign government when the latter elected to give the tax credit. I believe it came in two stages. It is difficult to obtain the details of these intergovernmental negotiations abroad to find out exactly why anything was done. They will not give them to you.

Senator Benidickson: But your statement involved two types of revenue, or the saving of revenue, proposed in the White Paper.

The Chairman: The significant point is that we must assume that these facts are known in the international area. If we find it necessary to go to these same countries who have brought about this change in the French situation we may well encounter that too, and if we want a theaty badly enough we may have to make the same concession.

Senator Benidickson: We had evidence yesterday that this same situation arose with the United States in negotiating a tax treaty with Belgium.

Mr. Phillips: I would say to honourable senators, though, that to the Aquitaine Company of Canada far and above the most important point in our whole presentation is the suggestion of the White Paper that the capital gains tax be imposed on foreign shareholders. The executives of this company are in Canada and say they are going to stay in Canada, and the executives of the parent. I think it can honestly be said that had there been this type of tax at the time of the original investment, there would have been very considerable re-thinking of whether or not to invest in Canada. The French company suffers only a 10 per cent capital gains tax in France, and all its calculations were at best computed on this basis. Had they at any time assumed that somehow, if they ever sold a portion of their shares, they would be subjected to a 25 per cent tax in Canada, at an earlier time, before they went public, perhaps a full tax had they been a closely held Canadian corporation, they would have rethought it. Now, this is not said in any way just to suggest that many other companies coming in may re-think on this basis.

Although I said I would not discuss this, if you take into account the five-year revaluation which may apply to the French company—which incidentally would get absolutely no credits against French tax; it might have to pay tax in Canada this year, and if it ever sold its shares later pay perhaps some additional tax in Canada, and its 10 per cent tax in France and get no credit in France for

revaluation tax; that has been checked out; they would not get any credit...the combination of all these matters pushes the foreign investor into the position of asking whether it is really worth it.

Except, as I said, for Germany and the Netherlands, no other country attempts in any sense to impose a tax on foreign shareholders; it is just unknown in the international taxing community. So far as Germany and the Netherlands are concerned, I would guess we will not be there say five or ten years from now, because it has not been very satisfactory; you cannot control it; international courts will not enforce it; you cannot reach it, investigate it or force the terms; you cannot ask for statements; you cannot reach the taxpayer.

The Chairman: What would you suggest be done with paragraph 6.47?

Mr. Phillips: Eliminate it, sir.

The Chairman: Eliminate what?

Mr. Phillips: The last sentence of paragraph 6.47. Although it does not directly apply to this taxpayer, one would say that the same thing should go for 6.46. You see, the idea of a back-up provision to place the responsibility on the purchaser and certificates of compliance is described as "an awkward but necessary evil". Awkward, yes; necessary, we doubt. It seems that most other countries have lived quite happily without taxing foreign shareholders investing in their respective countries, and we hardly see that it is necessary in the circumstances.

The Chairman: To the extent that Aquitaine declares any dividends under the present law and those dividends go to the parent company, there is Canadian withholding tax.

Mr. Phillips: Yes, 15 per cent. There is not a degree of Canadian ownership as yet which is sufficient to bring it down to the 10 per cent.

Senator Molson: You would say that in general terms a country in Canada's position, which needs such enormous sums of capital to be invested here, simply cannot afford the luxury of some system which is more expensive than that of other countries in the international business scene.

Mr. Phillips: Yes, sir.

The Chairman: You mean it flies in the face of the international attitude and practice, and may produce little or no return.

Senator Carter: If we are thinking in terms of principle, would you say the principle in the White Paper you complain about is exactly the same in Canada as that complained about in respect of the United States on many occasions.

Mr. Phillips: Yes, sir, on different aspects, because the United States, with all its attempts to reach foreign operations, has never attempted to tax foreign trading in shares of United States companies, nor for that matter to tax foreigners on domestic trading. With respect, the term does not mean much, because a foreign company wanting to sell to a United States buyer just makes its trade through an offshore entity, or a non-resident broker, a broker in Paris or London. There is no point in dividing between sales by a foreigner to a domestic or another non-resident. No, they have not, except where they think standing behind it all are United States citizens or United States companies who are avoiding taxes. There would be no objection to it. We are not objecting to the closing of any of the loophole provisions. We are talking of a conventional sense, where you have an honest non-resident controlling shareholder, or shareholders for that matter.

Senator Gélinas: To what extent does Aquitaine control its Canadian subsidiary Banff?

Mr. Phillips: The actual number of shares is under 50 per cent; 42 per cent of Banff.

Senator Gélinas: I was under the impression that an offer had been made to exchange shares of Aquitaine for Banff Oil.

Mr. Phillips: At the moment the public announcement has been made that procedures are being taken to make Banff a wholly owned subsidiary of Aquitaine. The actual procedures for that have not been effective; we are still awaiting tax rulings in the United States and Canada. As has been mentioned to this committee before, since you cannot get tax rulings officially here, that is one of our problems, because of the vast number of public shareholders, we really have to try to be as close to knowing what is going to happen as we can. That is what is holding it up at the moment.

The Chairman: I suppose if you created a triangle and superimposed some company in the United States on top of Aquitaine, and then had the relationship to go from there back to Paris, you might be able to use the United States tax system on grossing up of foreign tax credits.

Mr. Phillips: I do not think it is proper, perhaps, but this type of tax imposition, which is illogical in the international community, is just an invitation to hundreds of procedures. I mean, the simplest one, as I mentioned before, is just bear shares. It is impossible to keep track. If the controlling shareholder chooses to play around with bear shares or deposit receipts or anything like that, the Canadian Government just will never know. Big companies do not want to do that.

Senator Benidickson: You say they cannot collect under international law.

Mr. Phillips: They cannot collect anything.

Senator Benidickson: Through the international courts?

Mr. Phillips: That is correct.

The Chairman: Are there any other points you wish to make?

Mr. Phillips: We have made most of the other points in our brief, and I think these other ones have been covered. If there are any further questions we would be happy to answer them. Again, we would like to stress our really serious concern on the first point. I cannot express to you how onerous this would be, not only for this company, but for the whole Canadian economy. It is one of the worst provisions of the whole White Paper.

The Chairman: Whatever you say on the point we have been discussing applies at least with as much force to the unrealized or deemed to be realized capital gains.

Mr. Phillips: As I said, the first point is onerous, and the second one is overwhelmingly onerous and particularly with no offsetting tax credits. I feel that I dealt with it to such great length that it is not necessary to continue on the point and take the time of this committee.

The Chairman: There is an old saying that when you have sold something, wrap it up.

Mr. Phillips: Then I have wrapped it up, sir.

The Chairman: The next brief is from International Utilities Limited. Mr. Yorath, Chairman of its Executive Committee, is going to make an opening statement.

Mr. Dennis K. Yorath, Chairman, Executive Committee, International Utilities Corporation: Mr. Chairman and gentlemen, I will just add a few remarks about myself. In addition to being chairman and executive of the committee of International Utilities Corporation, I am also a director and vice-president of that company. Prior to this I was president and later chairman of our Canadian Western Natural Gas Company. I am still a director of that company as well as of other western Canadian companies.

I have been with the company since 1924, a period of 45 years and I am now semi-retired from the utility companies. Our chairman and president asked me to advise you that he was unable to attend today because he had a commitment which he could not possibly avoid. However, he is going to appear before the House of Commons committee a week from today.

I do wish to say, sir, how much we appreciate the opportunity of discussing these problems with you today and the time you are devoting to the study. I am going to be very brief, and then I will turn the presentation of our submissions over to Mr. Stewart.

My main purpose is to advise you, if you do not already know, how International Utilities Corporation has been throughout its lifetime with or without Canadian residency. Now that we have the residency we do not want to lose it. We Canadians who have been employed by International Utilities Corporation over the years intend to fight for the continuance of that residency as strongly as we can, and we are strongly supported by our American colleagues.

To give you a few facts on the situation of values, after International Utilities started in 1924, for the first 25 years of its history its only operations were the Canadian utility companies in Saskatchewan, Alberta and British Columbia. It lost its Saskatchewan property when the C.C.F. Government took over, and it disposed of its properties on Vancouver Island.

In 1960 I.U., as we call International Utilities Limited, embarked on a very major diversification program. In 1961 it took out its Canadian residency. As a result of that residency there was a startling change in the geographical holding of the company's common shares. At that time they were in the range of 64 per cent to 66 per cent of the total shares issued. Within a very few months after the residency in Canada that situation

turned around completely and the figure became 62 to 64 per cent in Canada. Our present situation with respect to common shares is that 68 per cent of them are held in Canada. Out of all our 26,000 shareholders, 15,000 are Canadians. At the present time our distribution of common securities—we have several different classes—is approximately 49 per cent in the United States and approximately the same amount in Canada, with two per cent held in other countries, primarily the United Kingdom.

Our securities are listed on exchanges in Europe and North America, three of which are in Canada, located in Toronto, Montreal and Vancouver. We have a board of directors consisting of 11, six of whom are Canadians. We have an executive committee totalling five members, four of whom are Canadians.

At the present time the company has assets totalling approximately $1 billion $300 million. Its revenues for 1969 were in the neighbourhood of $800 million, and its net income was $35.8 million.

Senator Beaubien: You say that your net revenue was $800 million.

Mr. Yorath: Our total revenues. We are a very widely operating company all over the world. With that, Mr. Chairman, I will turn over to Mr. Stewart the presentation of our submission.

The Chairman: Do you operate through a corporate vehicle or through branch operations?

Mr. Yorath: Corporate vehicles.

Mr. Murray E. Stewart, Group Vice-President, International Utilities Corporation: Mr. Chairman, my name is Murray E. Stewart and my responsibility is Group Vice-President of International Utilities Limited, but principally with Canadian responsibilites.

One thought occurred to us after we submitted our brief and that is perhaps we should have done what the Hudson's Bay Oil and Gas Company did and include an annual report. We did not include it with the brief we produced, but we have some copies of our annual report and will be pleased to leave them on the table for anyone who might like to have them.

The brief which I.U. has forwarded is not intended to be a line by line or paragraph by paragraph critique of the White Paper, because you will have had lots of those from other organizations. It is only aimed at four particular areas, one of these being the main thrust of our brief, namely, corporate residency. The others were almost in passing, because we are well aware of the accredited nature of these. As someone said at breakfast this morning, the White Paper is not an invention of Mr. Benson, but of the Ottawa hotel keepers. It has done a lot of the gross national product.

The other three areas have to do with the treatment of dividends, capital gain tax, and the matter of passive income. Since you have had a good deal of comment on items 23 and 24 we are going to direct our main attention to summarizing the first of these four areas.

The Chairman: Please keep in mind that we would like to hear something about passive income.

Mr. Stewart: I have got two experts sitting beside me and they can comment at some length on the technical side of passive income. If you would like we can pass onto that when we get to the question period. I would like to quickly summarize for you just a couple of points on each of the three matters which are not the main thrust of our brief, and then come back to the residency situation where we think there is some uniqueness in international utilities and their particular position.

Speaking on the matter of dividends, we summarize our position on this matter. We have two points to make on the matter of dividends. The first is on page 10, namely:

> Shareholders of Canadian steam, gas and electric utilities should not be denied dividend tax credits under the proposed new system of creditable tax simply because the provinces share a larger portion of taxes paid by utilities than is shared in the case of industrial companies.

You have heard this one before. Our Canadian subsidiary companies are Canadian Utilities, Ltd., Canadian Western Natural Gas Company Ltd., Northland Utilities Ltd., and Northwestern Utilities, Ltd., The Canadian Gas Association or other industrially owned Canadian utilities have made separate representations and I do not propose therefore to go further on this point. I do not propose to deal with this matter at any length.

The Chairman: We understand the point very well.

Mr. Stewart: I think you do. It is a very serious one, and it is amazing to us that there

has not been a movement to solve it as yet, because it seems to be so clearly an inequitable position to have been taken, that it astounds us that it has not been cleared up already.

The second point we think which can be made and which should be made, under Dividends, is on page 13 of our brief:

> If an integrated system is enacted, Canadian shareholders should be allowed a credit for foreign corporate taxes paid as well as Canadian taxes; otherwise existing international Canadian companies will be less attractive to Canadian investors and international expansion will be discouraged.

The Chairman: That point was referred to the other day by Massey-Ferguson.

Mr. Stewart: Yes, I think they did and they made it rather well, according to the press report of what they had to say. I think the point is that Canadian companies should be encouraged to seek expansion abroad. However, the exclusion of foreign taxes from the tax credit computation should prove a powerful disincentive to them to do so. I think that we would agree with the comment made by Mr. Mair of the Hudson's Bay Oil and Gas Company.

Furthermore, if Parliament should decide—as we say at the bottom of page 14—against making foreign taxes creditable, we suggest that at the very least that the integrated credit computation be clarified to provide that the amount of creditable tax of a corporation is not diminished by dividends paid out to non-Canadian shareholders.

We believe there should be two categories of shareholders. The non-Canadians should not use up the creditable tax that they may have on their books which they may use as a credit for the Canadian shareholders.

The Chairman: It would then really be a bonus to the Canadian shareholders from the non-resident shareholders.

Mr. Stewart: I do not think it would be a bonus: it would be consistent with the principle handed down when they went to the 20 per cent dividend credit. This is not given to the non-residents, either. It would be a continuation of a practical incentive to the Canadian investor to invest in Canada. We have not always found that there may be that result but the incentive has not been there.

On page 16 we comment quite briefly on the capital gains tax in the matter of capital gains. The first comment is this:

> The five year revaluation proposal should be rejected as contrary to established tax practice throughout the world of taxing only realized profits.

I think you have had that one *ad nauseam.* We submit that it is pretty hard to pay tax out of profits that you have not got, and that is a pretty fundamental objection to the proposal.

The second point in that area of capital gains is this:

> The initial values established on valuation day should be the higher of cost or market value.

You have also heard that one before and I am not going to comment further on it. The next point is on page 18:

> The valuation day should be fixed as of a date after the new law has been enacted.

You have also heard that one too. We think it worth emphasizing it because we feel that the discriminatory treatment of Canadian utility companies has resulted in the very serious sag in the market value of equities. If someone should strike a value the day before yesterday, or perhaps February 1st would be even worse as valuation day, for utility stocks, and then in their wisdom they did not go ahead with the proposal under the White Paper, there would be a capital gain automatically on those shares that would be completely artificial, and that would be caused by the White Paper itself and it would be inequitable in the extreme.

The fourth point is given on page 19:

> The deemed realization of capital gains upon leaving Canada should be eliminated since the proposed rule would unduly restrict the movement of personnel, particularly between Canada, the U.K. and the U.S.

This is a point that we have some feeling about, because we are an international company, we do move our people about from country to country and from company to company. Section 3.40 of the White Paper would provide that the taxpayer who leaves the country is deemed to have sold all of his assets that day and that if he had a capital gain, on their fair market value, this is a gain to that taxpayer. This obviously could mean that a successful Canadian who had appreciated assets

is really not a candidate for a move elsewhere. Despite the fact that he has moved elsewhere, it might be good for Canada, it might not be because of the brain drain, it might be a man going to Canada, going to the United States or going to the United Kingdom or going somewhere else, receiving training at Canadian hands and coming back. If he is a Canadian all the time, and is with an international company, because he does come back, we do not believe that this kind of restriction should be put on his mobility.

The comment on Passive Income is very important from the point of view of our company. Not being a tax expert, I will be very brief on that. We are quite prepared to elaborate on it. It is given at the top of page 21:

> The passive income provisions of U.S. subpart F should not be enacted by Canada since they have proven ineffective and unadministrable in the United States.

Something that is disliked in another country is not something that we should adopt.

If I may come back again to the main thrust of our brief, the residency issue. In this particular respect, we believe that our company is unique. As Mr. Yorath has pointed out, International Utilities was incorporated in the State of Maryland in 1924. That is given in the first page of our brief—and it is still a United States corporation. But in 1961 it became resident in Canada for Canadian tax purposes, since it has been directed and controlled in Canada and by legal definition was eligible under Canadian tax law to be a resident of Canada. We have a predominantly Canadian board of directors and a predominantly Canadian executive committee. The Canadian residency is based on a long-standing British and Commonwealth tax principle that the situs of a business corporation depends upon substance, and not merely form. It does not depend on the corporation, but where you are at, and the place it calls home and the place where it is actually directed and controlled is where it lives, not merely its jurisdiction of incorporation.

The Chairman: You do your housekeeping in Canada?

Mr. Stewart: That is right. We make some money here, too.

Sections 4.66 and 4.67 of the White Paper propose that only corporations actually incorporated in Canada will be treated as "taxable Canadian corporations" and that after a five year grace period Canadian shareholders of foreign corporations resident in Canada will not be eligible for the new system of dividend credits, nor will the shares be given the preferred treatment of Canadian companies when capital gains are realized. It seems clear that this particular White Paper proposal was made for two main reasons:

> (1) To bring all Canadian corporations within Canada's taxing jurisdiction; and
>
> (2) To eliminate possible tax avoidance caused by foreign corporations resident in Canada terminating their residence at will.

That would mean their simply closing up and going back to where they came from.

We do not disagree with the first of these two points, which is now the law with respect to corporations incorporated after April of 1965. We see no objection to making all Canadian corporations fully taxable. However, we take issue with the second point—because it hits us right where we live: right in Canada—that the potential tax avoidance involved in Canadian residency for foreign corporations means that all corporations incorporated outside of Canada should be precluded from maintaining tax residence here. We do not believe that foreign corporations resident in Canada should be precluded from tax residency. We suggest that any potential tax avoidance can readily be eliminated by specific legislation aimed at the avoidance itself rather than taking a broad brush and painting across all of the resident foreign corporations and forcing them to move from Canada.

We have proposed in our brief to your committee that corporations incporated in jurisdictions outside of Canada which conduct a business as Canadian residents under the present law should be permitted to retain their Canadian residency; so that, one, their income will be fully taxable; two, their shareholders will receive dividend credits under the proposed integrated system; and three, their gains will be taxed at the half rate applicable to Canadian corporations. If Parliament, despite our pleadings, should nevertheless decide to render foreign corporations generally ineligible for tax residency, we propose that an exception be created for companies such as International Utilities, whose residence has been maintained in Canada for a substantial period of time—in fact, since 1961—and whose shares have been listed during that period on one or more Canadian

stock exchanges. As a matter of fact our shares have been listed on the Toronto and Montreal stock exchanges since 1937 and for more than the first 15 years of our life our principal activities have been almost all Canadian, and 68 per cent of our common stock and 49 per cent of all outstanding stock is owned by some 15,000 Canadians. So we feel an exception should be made for this type of company. Basically we are saying that we do not see why we should be discriminated against by this type of legislation which would not enable us to have the option of choosing the country in which we wish to be resident, but rather would force us to go elsewhere.

We believe that there is no tax avoidance involved in our current residency status. Moreover, we do not believe there ever would or could be. Every dollar that we might save in Canadian withholding taxes on intercorporate dividends in Canada is offset by the withholding tax paid to Canada—by reason of our Canadian residency—on dividends to our 11,000 shareholders resident in the United States, the United Kingdom and elsewhere.

The Finance Minister's rationale for excluding all foreign corporations from tax residency in Canada is based almost entirely on the potential revenue loss involved because foreign companies resident in Canada may "go home" and therafter escape Canadian jurisdiction without suffering adverse consequences. Keep in mind, of course, that the "foreign" companies I am referring to are controlled in Canada; they are not in a foreign jurisdiction.

We submit that there are other, more reasonable ways of keeping these companies from coming and going from Canada as they please. For example, the Income Tax Act could be amended to provide that the change in residence of a foreign corporation be made subject to administrative review in situations where the principal purpose of the move is the avoidance of Canadian taxes.

Perhaps the legislation would be similar to that which was used to prevent surplus stripping of companies.

The Chairman: Mr. Stewart, just how could a company such as yours go home?

Mr. Stewart: I don't know. That is pretty fundamental, but the minister obviously thinks we could.

The Chairman: You carry on active business here in Canada.

Mr. Stewart: Yes. We could give up our residency in Canada and go back to the United States, though.

The Chairman: If you are going to continue physical operations in Canada you need some vehicle; if it is International Utilities with its residency in Canada, I suppose you could superimpose your headquarters in the United States and there might even be some tax advantage in that under the White Paper. But I cannot see how you could pick up your marbles and go home. That is what I am trying to figure out.

Mr. Stewart: You must keep in mind, Mr. Chairman, that International Utilities is a holding company which holds Canadian incorporated companies which do the business. Our business in Canada is carried on through purely Canadian companies, a couple of which are public companies. International Utilities itself does very little commerce in Canada; it is just a holding company.

The Chairman: In that sense it would be simple for you to sell the controlling interests in International Utilities of Canada to a United States holding company. You would get a full flow through of foreign tax credits in the United States then. In that sense your problem is similar to Massey-Fergusson's except that they are a Canadian company; but you both have your headquarters in Canada.

Mr. Stewart: But their problem is the bringing of money out of Canada in non-tax treaty countries, whereas our problem is that while our company is resident in Canada it is not incorporated in Canada and the White Paper is saying to us that after five years we must incorporate in Canada, which is not practical, or we must go back to our country of incorporation or elsewhere. The two problems are very different in that sense, even ignoring the fact that the two companies might be identically owned.

Senator Isnor: Why is it not practical for you to incorporate in Canada?

Mr. R. Baxter, Vice-President, International Utilities Limited: The basic reason is that the tax cost would be catastrophic. The second reason is that there are corporate structural problems such as complying with trust indentures that would make it difficult to reincor-

porate in Canada. But the taxes payble in the United States would be astronomical.

Mr. Stewart: A moment ago we were talking about the problem of tax avoidance; we feel that an administrative review could prevent tax avoidance taking place. Moreover, foreign subsidiaries of companies domiciled outside of Canada could be made ineligible to maintain tax residency in Canada. This would prevent a foreign company from setting up a foreign corporate subsidiary resident in Canada, which could operate in Canada without paying the branch operation tax of 15 per cent and without ever paying Canadian withholding taxes, if it should first terminate its residency and later pay out Canadian profits to its current corporation.

The ability of a foreign corporation, or a handful of foreigners, to set up a foreign corporation which does business through a Canadian office with a board of three or four Canadian lawyers and then escapes the 15 per cent branch operation tax, goes away and pays out its money without also incurring a withholding tax, we feel is the basic concern the Department of Finance has in this respect. We feel that that concern is legitimate.

We submit that the two suggested limitations upon foreign corporations resident in Canada, the administrative review procedure and the keeping out of foreign subsidiaries of foreign companies, are more than sufficient to meet the apparent purposes of the White Paper proposals.

Assuming, however, that Parliament is nevertheless convinced that foreign corporations should be removed from Canada on a wholesale basis, then we suggest that there are equitable grounds which justify treating public companies like IU differently. Under those circumstances, we would ask the IU be permitted to maintain its resident status under an exception contained in the new legislation. We suggest that this be done for three principal reasons; first, many of our 15,000 Canadian shareholders have purchased IU assuming it to be a Canadian company and believing it to be a Canadian company and relying on the long-established residency doctrine and these shareholders will obviously be adversely affected should they lose tax credits under the proposed integrated system and also the half-rate tax on capital gains. Secondly, we would submit that a public company such as IU is simply not geared to engage in tax manipulations across international boundaries and thus is not the typical tax avoidance situation which the White Paper is aimed at. And third, we would submit that if IU no longer qualifies as a "taxable Canadian corporation", with respect to its capital stock, it seems inevitable that IU's Canadian shareholders will gradually sell out, and the shares will be purchased in the US and elsewhere, thus causing IU's share ownership to become predominately non-Canadian.

Speaking as a Canadian, the movement from some 42 per cent in 1961 to some 68 per cent of the common shares and this has been a continuing movement right through those years—has been pretty thrilling. The fact that 49 per cent of the total outstanding stock in IU is owned in Canada is something that I think Canadians can be proud of and I think it is something that is going to increase as the months go by. I do not think we should put anything in the way that would change this pattern so that it flows in the other direction, if it can be helped.

We suggest that Canada has nothing whatever to lose in carving out such an exception so as to permit IU and other companies similarly situated to retain their Canadian identity and orientation.

One final point which goes to the general question of foreign ownership of corporations actually incorporated in Canada. We all know that there are hundreds of Canadian corporations like Aquitaine which are not owned in Canada, but where, I think, 82 per cent is foreign owned. And these are run from dear-knows-where, Detroit, New York or London, or almost any place. All of these companies will qualify as Canadian residents for tax purposes. On the other hand, you see before you a major international company with wide Canadian ownership, and an ownership that has been growing fast over the past ten years, asking you to help us not to be forcibly removed from Canada by tax reform.

We submit that ours is a case that merits your attention. IU sincerely hopes to retain, following enactment of tax reform legislation, no matter what form it may finally take, the ability to maintain its Canadian orientation and ownership.

The Chairman: So, has the train stopped?

Mr. Stewart: The train has stopped.

The Chairman: All right, I want to ask you a question. Do you have any language that you could suggest to us that would describe the kind of exception you want?

Mr. Baxter: I think the language is right there in our brief. We are suggesting that a publicly-owned Canadian company which has remained a Canadian resident for, say, ten years and whose shares have been publicly listed in Canada for that period be excepted from the coverage of any new legislation.

The Chairman: But IU is not a publicly-owned Canadian company.

Mr. Baxter: Yes, sir.

The Chairman: It is a United States incorporation.

Mr. Baxter: Yes.

The Chairman: Instead of having to work the language of an exception out of your brief, have you prepared language which you think would be satisfactory and would provide for the necessary exceptions?

Mr. Baxter: No, sir, not specifically. But we would be delighted to furnish a supplementary letter to that effect.

The Chairman: I think it would be advisable and see whether we can go along with it or whether it should be changed. But we would like you first of all to put your language in to describe what it is that you want by way of exceptions.

Mr. Stewart: We would be happy to do that, Mr. Chairman.

The Chairman: Can you do it soon?

Mr. Stewart: Certainly.

The Chairman: Honourable senators, are there any questions of Mr. Stewart before we ask the two men with him questions on passive income?

Senator Molson: Has IU got any shareholders holding a really significant or substantial block of shares that can, in any sense lead to control? I am not speaking of somebody holding 51 per cent of the shares, merely holding a substantial block.

Mr. Yorath: Yes, Mr. Chairman, we have some shareholders and one in particular whose name I cannot disclose who is a very substantial shareholder with over 1 million shares.

Senator Molson: Over a million shares. What percentage is that?

Mr. Stewart: There are 14 million shares outstanding at the present time.

Senator Molson: That is about 7 per cent.

Mr. Stewart: We have a Canadian nominee who holds one and a half million shares, and we list him as one shareholder. It may be 600 shareholders, but it is a million and a half shares in the hands of one trust company.

Senator Molson: So those two control two and a half million shares roughly, but other than that, is there any one significant block?

Mr. Stewart: The shares are widely held and the average holding is not in the hundreds of thousands of shares or anything like that.

The Chairman: I take it there is not a block that could be described as effective control?

Mr. Stewart: No.

The Chairman: You have not experienced that in the corporation.

Any other questions of Mr. Stewart? Well, then, can we learn something about passive income?

Mr. Stewart: These two gentlemen were hoping this question would not arise.

Mr. Baxter: I might add that sub-part (f), as is well known, is one of the most difficult and complex sections in the Internal Revenue Code, and what we are suggesting simply is that Canada should not repeat the error the United States made in 1962.

The Chairman: I suppose you could avoid that by a specific definition of what is passive income.

Mr. Stewart: That is the trouble, isn't it?

The Chairman: And define it before you decide what you want to do with it.

Mr. Baxter: I think what you can do is that you can control individuals who may have invested in tax haven jurisdictions in order to evade Canadian taxes but where sub-part (f) normally operates on corporations with international operations. As a practical matter, we have to live with sub-part (f) anyway, because we are a United States taxpayer also, and we have never had any trouble whatsoever with it. At the same time, I don't think we would have a great deal of trouble living with it if Canada enacted it, but we think it is unnecessary and we would hate to see Canada enact it.

Senator Benidickson: This was introduced in 1962, is it still in effect?

Mr. Baxter: Yes, sir, it is still in effect, but it is subject to major revision at the moment, I believe.

Mr. Brennan, Director of Taxation, International Utilities Limited: Because it is presently mandatory, the Treasury Department has to make some recommendations for changes that they have had under contemplation for some years. The last time we were in Washington, we spoke to one gentleman about one specific section being excised specifically from the code.

The Chairman: Well, I suppose if we want to learn something about passive income, we are going to have to study the sub-part (f) since it is identified in the White Paper.

Mr. Baxter: There is a fellow by the name of Alan Short whom you undoubtedly know and who works at the Department of Finance, and his job right now is to draft a Canadian sub-part (f), but he is not yet sure what that draft will contain, but when he gets the job done, it will presumably be published and this committee and we and other commentators will have an opportunity to look at it. But I think you might be spinning wheels unnecessarily.

The Chairman: Well, then, let me put this question to you; what purpose is to be served or what purpose does the Government hope to serve by introducing the limitations in subpart (f)?

Mr. Baxter: I think the Government hopes to avoid corporations acting in a way so as to minimize their total taxes by doing something through a foreign corporation they would otherwise do through a Canadian corporation.

The Chairman: Let us take an illustration. Supposing I am a manufacturing business in Canada, a Canadian company, and I decide I am going to separate my domestic sales from my foreign sales, so I set up in some tax-haven jurisdiction a marketing company for the whole world, excluding Canada. Then I sell from Canada to this marketing company. Under your sub-part (f) would that type of operation be covered?

Mr. Baxter: I think it would be.

Mr. Brennan: If I understand the example, it would be covered.

Mr. Baxter: It is incorporated in the Bahamas and actually operates in other countries. I think that would trigger sub-part (f).

The Chairman: But if I incorporated my world marketing agency in France or the U.K., in some country where you were not tax-free, then it would not be classified as income under sub-part (f).

Mr. Baxter: No, sir, I think it would still be covered by subpart (f).

The Chairman: Well, that is getting to be a bit of nonsense, is it not?

Mr. Baxter: A lot of people in the U.S. think it is.

The Chairman: Yes, so I have heard.

Mr. Phillips: Mr. Chairman, I cannot speak to subpart (f), but I think the present Canadian law is that if you have one of these offshore subsidiaries which is no more than a sham and has no real reason for its being, and is effectively managed and controlled from Canada and is not a real offshore company, you do not need to change the law; it is taxable right now.

The Chairman: That is right, the offshore operation would be regarded as an agency operation by the Canadian Government.

Mr. Phillips: The problem, as we have seen it, has been one of lack of administrative ability. They have all the tools right now, in terms of statutory powers, to control it; the problem is an administrative one.

The Chairman: They not only have the tools, but they have the information.

Mr. Phillips: It does not appear that it is going to be a great deal better once you get subpart (f) than under the present law. It is just as good now as it would be under any subpart (f) procedure.

The Chairman: If a company divided its operations and put some of them in an offshore tax haven, that would be reflected in some form in their balance sheet.

Mr. Phillips: That is right.

The Chairman: So they have the material and they have the present law.

Mr. Phillips: I cannot speak for the U.S., but I am speaking of the Canadian law. This is at least what we see as one of the major reasons, that it is just adding another set of statutory complexities to a situation which is completely covered now, if properly administratively handled.

The Chairman: Like entertainment expenses!

Mr. Stewart: We did not comment on that in our brief.

The Chairman: The problem must be administrative in the case of entertainment expenses.

Mr. Phillips: I would also add this one point that I know is important and should be brought up before we close, that just lately the United States, with regard to what are commonly known as DISCs, these new export corporations, after going to great lengths in subpart (f) to try to control some of these things, they finally came to the conclusion they could not do so and were losing business and so enacted brand new legislation to reinstate export companies which runs completely across the whole protective provisions of subpart (f).

The Chairman: Of course, there is this element you have to look at in export companies in different jurisdictions outside of Canada, that you may need an export company in some form in order to do business.

Mr. Brennan: The provision Mr. Phillips was referring to is newly introduced legislation in the Congress whereby a U.S. company could buy from affiliates and export the goods to non-U.S. markets and make a profit and not be taxed for a period of 10 years, so long as the profit it made was a reasonable one.

Senator Molson: How do we measure that one?

The Chairman: Is there anything else you would like to add?

Mr. Stewart: I do not think so, Mr. Chairman.

Senator Burchill: What about reciprocal arrangements with the United States? Are there any Canadian companies incorporated in the United States doing business down there?

Mr. Baxter: It is very interesting. There is an analogous provision in the U.S. Internal Revenue Code which has the effect of giving U.S. residency to a Canadian company. It is not couched in those terms, but section 245 of the U.S. Internal Revenue Code says, for example, that when a U.S. corporate shareholder receives a dividend from a Canadian company, most of the income of which is earned in the U.S., then that U.S. recipient of that dividend gets a dividend-received deduction, just like a Canadian individual would get a dividend tax credit. So I think there is an analogy, that there is a situation in which the United States would do the same thing for a Canadian company as we are asking Canada to do for a U.S. company.

The Chairman: Are there any other questions?

Thank you very much.

The Chairman: Now, honourable senators, we have one more submission, that of King Resources Company. We have with us Mr. H. N. S. MacKenzie, the Vice-President; Mr. R. Gail Duffy, Assistant Division Manager; and Mr. Glenn E. Holmes, Division Financial Manager. Will you make your opening statement, please, Mr. MacKenzie?

Mr. H. Neil S. MacKenzie, Vice-President, King Resources Company: Thank you, Mr. Chairman. We very much appreciate this opportunity to present our views to this committee. It really is a pleasure to stand before a group with the depth of experience and expertise that you have and to be allowed to make a presentation where we can, in fact, before an effective body give vent to our enormous concern over the consequences of these proposals.

I should like first to make an apology to those gentlemen among you whose native language is French. We did not prepare a French version of our brief because we really did not have time after we were informed of the date by which the brief had to be in. We in Calgary did not feel we knew a translator whom we could trust to put into the French language the nuances of meaning which are so important, and which we ourselves unfortunately would not be in a position to edit. With that apology I should like to proceed.

The Chairman: Yes.

Mr. MacKenzie: This brief is presented on behalf of ourselves as Canadian citizens and our company which is an American company operating as a division in Canada. We have attempted previously to create a Canadian corporation, but have been frustrated by certain tax problems. When we thought we had discovered a manner of doing this the White Paper hit the street and, of course, it would be financial lunacy to have that kind of creation at this time with the five-year deemed realization provision.

I should like first to say a few words about our company. King Resources Company is a technological company oriented toward the development and management of national resources, be they oil, gas, minerals or land, and the blending of this talent with the management or directions of moneys for institutions, corporations, and individuals seeking a direct ownership participation in natural resource projects.

On a world-wide basis, on behalf of itself and its clients, King Resources has one of the largest group of technological personnel devoted to natural resource exploration and development, and through its associates it manages, participates in, or directs one of the largest budgets devoted to the search and development of new natural resource projects, making it competitive with the largest international companies.

Our company deeply respects and practises the policy of attempting to give each individual employee maximum opportunity to demonstrate his capabilities. The maximum amount of individual autonomous action is constantly striven for while still maintaining a coherent structure of internal communication and policy control. This is not easy, and it is often tempting for management to tighten up the organization.

The policy of maximizing individual talent by attempting to offer freedom for autonomous responsible action has given us great operating flexibility and substantial success, as witnessed by our record of growth. King Resources Company and its associated companies have leapt from a gross volume in 1966 of some $20 million, to more than $420 million in 1969, almost all of which activity emerged from internal generation and not acquisition and mergers.

We have developed into a multinational firm. We believe strongly that a multinational firm should not only have the ability to provide capital and needed services, but should have both capability and the activation to raise capital within the nation involved for the discovery, development, and production of its own natural resources. The corporate entity should be willing and desirous of sharing its growth with the countries in which it seeks natural resources.

We believe that Canada has the greatest thing going for it in natural resources in the history of the world. We are sincerely convinced that with the rapid increase in technology now available the whole natural resource industry in Canada will find natural resources over the next ten years that will exceed in value and in amount all of the natural resources that have been discovered in all of North America to date. This is a beautiful environment in which to work. It is going to need a great deal of capital. We hope that we can structure vehicles which are appropriate and attractive to Canadians.

We do not like what is going on. We do not like the changes that appear to be taking place, and that will take place if these laws are enacted. Far from encouraging and rewarding individual creativity and responsibility, the proposals would penalize the successful, creative, and thrifty, and transfer what should be their wealth and additional creative power to the public sector, thus centralizing economic power in the hands of a few bureaucratic civil servants. We believe that this would be a crying shame, based on all historical experience in all countries to date. It has been said that those who do not study history are doomed to repeat it. Surely, we do not wish to repeat the pattern set by what was once Great Britain after World War II—and so help me, we are headed right down that road.

In any case, we do not believe that there is nearly enough capital in Canada to explore and develop its resources, to keep pace with the growing world demand. We recommend, therefore, an environment that will both attract foreign capital relative to other competing areas of the world, and an environment where Canadians can invest through the private sector—not through the public sector with tax moneys that have been confiscated—on a basis competitive with the foreign investor. The effect of the White Paper proposals would be to work entirely against these recommendations rather than for them.

We feel that in drafting the proposals there has been a real lack of concern for the effect on the world-like economy. The people who drafted this have done so as though they are surrounded by walls, and are trying to seek what is for them an idealistic and perfect environment without concern for the international consequences.

We are ourselves multinational. We are involved in give and take trades on a world basis, and we are absolutely satisfied that this will be ruinous—it will certainly be ruinous to our operation, and disastrous to this country.

The other thing that we are concerned about is that in order to achieve perfection by

saying that you are going to have a system with no loopholes you get into a situation which would be rather similar to an attempt to have, say, a perfectly effective police force. If that were done we would have no privacy. The police would have the right to tap telephones and invade privacy to any extent. In those circumstances we would have no criminals, but we would have a very unhappy society. We would prefer to see a society in which a few people can get away with criminal actions, but the society is basically one in which the individuals in it take the responsibility for it, rather than have that responsibility taken away by governmental control.

In our brief we have elaborated the points that concern us. Perhaps my introduction has been too wide-ranging in its scope, but I thank you again for allowing me to express the concern which I tell you is felt by this group, by its employees, and in the west generally.

In order to get it into the record I should like to read the summary and conclusions which are contained in our brief. This is at page A.

It is our opinion the White Paper proposals for Tax Reform will have the following undesirable effects:

1. They will work an injustice on those who have taken extraordinary risks, and made extraordinary sacrifices, in their investments and their business undertakings.

2. They will reduce incentive for Canadians to save and create investment capital.

3. They will reduce Canada's world competitive position for foreign investment.

4. They will continue the advantages which foreign investors enjoy over Canadian investors in the area of Canadian natural resources.

5. They will impede the establishment of Canadian public companies.

6. They will reduce the attractiveness of investment in the natural resource industries.

7. They will encourage interprising Canadians to emigrate to the United States or to other countries (which is not in there, but should be) because of the substantial difference in personal tax rates between Canada and the United States and other countries.

8. They will cause a major increase in centralization of investment power at the expense of individual freedom.

9. They will cause many taxpayers to lose their respect for the tax system.

Our recommendations for changes to the proposals which would improve their effectiveness are as follows:

1. Capital gains should be taxed separately from regular income, and certainly with no more severe treatment than in the United States.

2. There should be no deemed realization of capital gains under any circumstances.

The White Paper has no terms of reference with respect to death duties. Christianity is supposed to have taken the sting out of death. That has handled one grim reaper, but the Government has effectively created another. There seems to be no integration of capital gains with the death duty situation. The terms of this are in respect to the proposals in the White Paper.

3. Foreign corporations doing a significant portion of their business in Canada should be treated as widely-held Canadian corporations.

We are thinking particularly of the situation which has just been elaborated by International Utilities Limited.

4. The 21 per cent tax on the first $35,000 of corporate taxable income should be retained, or alternative incentives should be provided for small businesses to be formed and to grow.

5. Meaningful incentives for the risk-taking extractive industries should be ensured.

6. The right should be provided for any Canadian individual, partnership or corporation to write-off all expenses incurred in exploration for petroleum, natural gas or other minerals against ordinary income, in the year incurred.

We know from our experience in raising money out of this country the enormous advantages that foreigners, particularly Americans, have over Canadians when investing money here. I am sure you are aware of this situation.

Those are my introductory remarks. Thank you very much.

Senator Phillips (Rigaud): Where is this company based?

Mr. MacKenzie: In Denver, Colorado. We are a division of that company, operating out of Calgary, Alberta.

Senator Phillips (Rigaud): How many employees have you?

Mr. MacKenzie: It has increased because of the Arctic operation we have undertaken. I would say 140.

Senator Phillips (Rigaud): You do not deal with the matter of integration, which is a basic scheme of the White Paper. Does that indicate your acceptance of it as being desirable?

Mr. Glenn E. Holmes, Division Financial Manager, King Resources Company: No. We have mentioned it throughout our comments, but we have not specifically made a case against integration.

I think we should have done so. Not stressing it more than we did is an error on our part.

Senator Phillips (Rigaud): Should we therefore consider your recommendations on the assumption that, being against integration, they are related to the present income tax law and whatever amendments would be made to it?

It is the only way to understand your recommendation.

Mr. Holmes: Yes sir, we would be against integration.

The Chairman: Mr. MacKenzie, in item 6 of your recommendations you state:

> The right should be provided for any Canadian individual, partnership or corporation to write-off all expenses incurred in exploration for petroleum, natural gas or other minerals against ordinary income, in the year incurred.

What is the significance of the word "all" there? The White Paper does contemplate the writing-off as an expense of moneys laid out for exploration and development.

Are there some significant exclusions?

Mr. MacKenzie: Perhaps we should have expanded that, sir. I am glad you asked the question.

By "all expenses" we are referring to the provision in the White Paper that only a portion of the eligible expenses in exploration can be written off by individuals or non-qualifying companies. Then they may be written off at 20 per cent of the declining balance annually.

Senator Molson: The fourth recommendation is that the 21 per cent tax on the first $35,000 of corporate taxable income should be retained for small corporations.

What are the views of the witnesses with regard to the proposal that the small company be defined and the lower rate retained for that small company as defined, but that the benefit does not carry through to large corporations?

Mr. Holmes: I do not think the benefit should be given to the large corporation.

Senator Molson: Would you then say that the small company should be defined?

Mr. Holmes: Yes sir.

Senator Molson: You mention specifically in your brief that you are very much in favour of the lower rate for the small company. Would you consider that to be a suitable means of achieving an equitable arrangement?

Mr. Holmes: Yes sir, I believe it would.

Senator Beaubien: How would you define a small company?

Mr. Holmes: On its taxable income. I would take a figure of $100,000.

Perhaps there would be other ideas as to what that figure should be, but I would think $100,000 of taxable income. Anything below that would be classed as a small business.

The Chairman: There are wide variations in classifications of small business. In the Small Businesses Loans Act an attempt is made to identify a small business. Originally it was one having sales of $250,000. This was subsequently increased to $500,000.

We discovered very quickly in these hearings that in softwear, merchandising, men's furnishings and women's wear, where the profit is small, the volume of sales that would have to be generated to produce $100,000 of net income would be so substantial that the business would have to be classified as big.

This leads us to believe that the definition should be based on the sales factor.

The question this morning when the Hudson's Bay Oil and Gas Company people were here was that if small business is defined simply by relating to the net taxable income, they might end up by earning only $100,000 in a year and they would qualify for the 21 per cent. Do you think there should be an

additional factor of capital employed or something of that kind?

Mr. Holmes: No sir I think I would prefer the taxable income base.

The Chairman: Then you would take the risk of Hudson's Bay Oil and Gas Company getting 21 per cent in one year?

Mr. Holmes: Yes I suppose you would but if your income does drop that low as I believe was said at the time they are entitled to a bit of a break.

The Chairman: In No. 5 of your recommendations you say:

> Meaningful incentives for the risk-taking extractive industries should be ensured.

You do not have to argue the point of recognition that incentives are needed or essential because even the White Paper assumes that. The only element therefore is quantum. Are they too great? I notice that you recommend a continuance of the depletion allowance as it exists and I believe you also recommend a continuance of the tax holiday as it exists. I would like to ask a question or two on the three-year tax holiday. Because of the way it has been used in many instances mining companies have enjoyed a tax-free period of maybe six or seven years because in the three-year period they did not write off any pre-production expenses, they saved them up. Would you agree that there should be some limitation along the lines mentioned in a memorandum I read this morning from James Richardson & Sons in which they suggest that we might consider limiting the tax-free period to three years or until some fixed percentage of the capital cost is recovered whichever is sooner. What do you think of that as being a reasonable limitation?

Mr. MacKenzie: I will ask Mr. Duffy to answer that question.

Mr. R. Gail Duffy, Assistant Division Manager, King Resources Company: We had a proposal in the brief that did suggest that some control element should be designed. On page 37 we have a very similar recommendation to that of James Richardson & Sons, where we suggest that this could be limited to the total cost of bringing the mine property into production. This has two effects. One of them is the bonanza situation that was discussed earlier, where there are extremely high grades and the tax holiday is a period of extremely high earnings, rather than a means, an incentive, to bring the property into production. Some form of limitation of that kind, we believe, could, and should, be applied to the three-year holiday.

The Chairman: If you subscribe to the principle that you should be able to write off all your expenses of bringing the property into production before you become subject to income tax you can do that and you do not need a tax holiday to do it. Is that not right?

Mr. Holmes: Perhaps I could add something here. I believe that because of the risk factor involved in bringing new mines into production the three-year tax holiday is a necessity.

The Chairman: What I was pointing out was that if you take the total cost factor that you have suggested in your brief, you would not need the tax holiday to do that, you just write off, and when you have written off your total cost your income is subject to tax. The Richardson suggestion would be helpful in the tax holiday period, because there would be an element of the income that you might earn that you would not apply expenses against, and therefore you would have some element of income, for whatever the purpose of the company, which would not be subject to tax in that tax holiday period.

Mr. Holmes: I believe there is a little misunderstanding. Our recommendation is that you use the cost as the measure of the amount of tax-free income that you can receive during the three years, but then you still write those costs off afterwards. For example, if you had a mine that took $20 million to bring into production and your income was $10 million a year, your tax-free holiday would go not for three years but for only two years, because you picked up your $20 million. After the second year you would start to write off your $20 million, and this way you would run through, say, four years before you were taxable, whereas now it is seven or eight years.

Senator Everett: Does the White Paper recommend a fast write-off, that the write-off can be used as fast as it comes? If you have a three-year tax holiday with the limitation you suggest moving on to the write-off that you say would be available to the company after that, do you suggest a fast write-off or a write-off based on a percentage?

Mr. Holmes: No, I would suggest the fast write-off, that the company could take it as it was available. This would in the case of bonanza situations—which I believe are the ones the tax department would like to catch;

I think somebody mentioned the Pine Point situation yesterday—instead of having a seven- or eight-year tax holiday, as that has turned out to be, you could end up with a four- or five-year one at the very most because you would have all your write-offs...

The Chairman: Mr. Holmes, the difficulty I see in what you call the fast write-off is that you do not need a tax holiday; you can just go ahead and write off. Assuming you do have earnings—because that is essential; a tax holiday is no good without earnings—the idea of a tax holiday as I conceive it, the incentive part of it, is to leave some income to the company in that tax holiday period that can be enjoyed as income and is not subject to tax. I think that is the basis for the Richardson recommendation, that you are required to write off a percentage of pre-production expenses each year of the tax holiday, but only a percentage, so as to leave some tax-free income in that period. That is the incentive. If you write off everything, you write off your expenses faster but you become subject to full tax more quickly. It is not conceding anything to say you can write off your expenses as fast as you incur them. You can do that.

Mr. Holmes: You are doing that now.

The Chairman: You do not need any direction in law to do that. The idea was how to transfer a tax holiday into a benefit or an incentive and avoid what may be called an abuse by not writing off anything in that tax holiday period. I think that is the reasoning behind the suggestion from Richardson and Sons. When you talk about total cost it is another approach.

Mr. Holmes: I believe Noranda had a similar approach to ours.

The Chairman: That might accomplish the same result, but to do so a tax holiday would have to go on for the three-year period.

Mr. Holmes: If you had a bonanza situation you might only have one or two years of tax holidays as I mentioned in the illustration.

The Chairman: I do not think so, Mr. Holmes. Your example is that you had total expenses of $20 million, and you might have income in the three-year tax holiday period of $10 million a year. Under those circumstances the tax holiday would only run two years. To get a tax holiday out of that you would have to refrain from writing off the expenses in that two-year period.

Mr. Holmes: That is right, and you would write the expenses off after the end of the second year.

The Chairman: That would prolong your tax holiday for a longer period. The thinking in the White Paper seems to be that this is an abuse feature.

Senator Phillips (Rigaud): Except that the tax holiday is related to incentive whereas the pre-production expenses are legitimate expenses which would be used up in a subsequent period. We are dealing, as I understand it, with two different situations.

The Chairman: The effect of taking the full tax holiday and not writing off any expenses is to prolong a tax-free period for maybe twice the tax-holiday period.

Senator Phillips (Rigaud): Except that the tax holiday comes under the heading of incentive legislation as distinguished from the ordinary rules of deduction against taxable income in respect of pre-production expenses. I do not think they are inconsistent approaches.

The Chairman: I was addressing myself to what Richardson recommended, and that is to prevent the kind of situation where you do not write off anything until the tax holiday is over. You establish a fixed percentage that you must write off, but you would still be left with some part of your income as tax free.

Senator Phillips (Rigaud): It is an alternative approach. There is something to be said for the concept that your tax holiday evanesces.

The Chairman: You must leave some part of it as producing tax-free income or you do not have any incentive.

Senator Phillips (Rigaud): That is a point. If you take all of your free production expenses and take the other extreme, polarization, and deduct it during the period of a tax holiday, it ceases to be a tax holiday.

Mr. MacKenzie: I would like to make a comment on that. I have some feeling about what companies are trying to achieve within the framework of the present system. Under the present system you have a three-year tax holiday, after which you can write off the pre-production expenses. The two are quite separate, because one is the incentive and the

other is the normal write off. If you are lucky you can find an extremely rich deposit and gear up your rate of take outs and the rate which you grind it through your mill. Therefore you are calculating your mill size and whole operation by cramming it into three years and highgrading everything that is in there. They do not want that and they say that it is taking advantage of the incentive which they give you. We say, "All right, we will set a ceiling on that."

Senator Phillips (Rigaud): These gentlemen have introduced an alternative conception.

The Chairman: It is an alternative to the conception that Richardson put forward.

Senator Phillips (Rigaud): That is my point. It might well be that this committee should consider in its report the two alternative suggestions.

The committee adjourned until 2.15 p.m.

(Upon resuming at 2.15 p.m.)

Senator Douglas D. Everett in the Chair.

Senator Everett: Honourable senators, in the absence of the chairman and the acting chairman, the chairman has asked me to take the chair for the remainder of this session. Is that agreed?

Hon. Senators: Agreed.

The Acting Chairman: Honourable senators, we will proceed with the examination of the brief of King Resources Company. This morning they made an opening statement and were examined on the three-year exemption from mining. Are there any further questions on that subject?

If not, perhaps we should move to page 34 of the brief, where the King Resources brief makes a special reference to a new method of calculating depletion. Would you like to comment on that?

Mr. MacKenzie: Yes, Mr. Chairman. I will ask Mr. Holmes to comment.

Mr. Holmes: Yes, Mr. Chairman. The present form of depletion is calculated on net production income, which is defined as your production income after deducting all your operating costs and also after deducting all your 83(a) expenses and, in broad terms, your exploration expenses.

We are recommending that we remain with a depletion allowance calculated on gross income, but that it be limited to 33⅓ per cent of net income, but that net income in this case be calculated prior to the deduction of the section 83 expenses.

The Acting Chairman: Are there any questions on this, honourable senators?

If no one else has a question, I would like to ask if this is not even more generous than the American system of calculating the depletion rate on gross income?

Mr. Holmes: No, I think it would be slightly less, although the rate that we have used here, 25 per cent, is 3 percentage points higher than the present American rate of 22. They calculate their depletion on a lease by lease basis, while we do it on an overall basis and generally speaking calculation on lease by lease basis would give a larger allowance.

The Acting Chairman: Supposing you were dealing with the individual leases, could you point out for the committee the difference between the American system and your proposed system.

Mr. Holmes: In effect, under the system as we are proposing, it is calculated on the gross income rather than a lease by lease basis. Therefore, in the American system if you had a lease with a loss, say, or something like that, that would not affect it.

The Acting Chairman: But if you were dealing with one lease, how would the two systems compare?

Mr. Holmes: Yes, if it were only a case of non-producing property, you would do it on one lease.

The Acting Chairman: Yes.

Mr. Holmes: In that case, ours would be more generous.

The Acting Chairman: Can you tell us why that is so?

Mr. Holmes: Yes. It is because we have higher percentage here—25, to their 22.

The Acting Chairman: That is, in effect, you are taking 25 per cent of the net, before development costs—is that the same as 25 per cent of the gross?

Mr. Holmes: No, we are taking 25 per cent of the gross income, that is, your gross oil receipts. The point here is not so much the different percentages. There are two things we wish to bring out here. The first point is that it is the percentage calculated on gross.

That is number one. Number two, that there is a limit on the net that would be a reasonable tax if you ceased to explore.

The Acting Chairman: Perhaps I could come at my question in another way. The Americans, as I understand it, impose a limitation of 15 per cent on the net income after exploration and development costs are deducted?

Mr. Holmes: Yes, that is right.

The Acting Chairman: And you are proposing $33\frac{1}{3}$ per cent net income?

Mr. Holmes: Yes.

The Acting Chairman: But based on the net income prior to the deduction of exploration and development costs.

Mr. Holmes: Yes.

The Acting Chairman: Is that not a good deal more generous than the American scheme?

Mr. Holmes: Yes. As I said earlier, it would be more generous than the American system.

The Acting Chairman: So it would be generous on two counts—one, the gross rate would be 25 as against the American 22, and the limitation on net income would be more generous than the American system?

Mr. Holmes: Yes, because the two terms "net income" are not the same.

The Acting Chairman: Perhaps we could move on, if there are no further questions, honourable senators, on that point. Have you any other comments on the depletion system?

Mr. Holmes: Yes, we have. We are asking that the present depletion allowance on dividend income be retained. This is given on page 36, Mr. Chairman.

The Acting Chairman: In whose hands is that—an individual's hands?

Mr. Holmes: Yes, sir.

The Acting Chairman: Would you tell us what is the basis for your suggestions regarding the deductibility of exploration and development expenses by individuals and companies whose main income is not in the mineral and oil business?

Mr. Holmes: Mr. Chairman, we have had a good deal of success on a world-wide basis in raising funds from individuals and companies who are not in the oil business. That is true particularly in the United States, where it has been a great source of capital to us. We believe Canadians who are not in the oil business should have a chance to share in the industry in the same way the Americans can at the moment. Therefore, we recommend that the principal business test be eliminated and that exploration expenses be deductible from ordinary income of either the individual or the company.

The Acting Chairman: Your opinion is that this would greatly increase the amount of money Canadians would make available for exploration and development?

Mr. Holmes: Yes. There is no way for a Canadian individual or Canadian company which does not meet the principal business test to invest in the oil and gas industry at present.

The Acting Chairman: In the first paragraph on page 61 you make the point that, because of the way the White Paper is presently constructed, effectively the amounts expended by a taxpayer on resource and development and exploration will be deductible from his other income because of the special operations of the White Paper. Whether the White Paper intended so or not this is what the effect will be. Would you explain that, please?

Mr. Holmes: In the White Paper, Mr. Chairman, it is stated that an individual will now be allowed to form a separate class of assets for exploration expenses. If he does not have any oil and gas income, he can deduct these expenses from his other income to the extent of 20 per cent on a reducing balance basis.

Paragraph 3.31, however, states that any loss on the disposal of shares of the closely-held company can be written off against other income. So that while the White Paper supposedly seeks to restrict the deduction of section 83 expenses to the extent of 20 per cent for those people who do not qualify as oil and gas companies, nevertheless, it leaves a loophole, in effect, so that these expenses could be written off. For example, four dentists wanting to go into the oil business could simply form a private company and, if the venture was unsuccessful, the shares would be just written off against their other income.

The Acting Chairman: Let us deal with that example. Suppose four dentists take $25,000 each for a total of $100,000 and go into the oil exploration business. Under the present Canadian law what are they allowed to write off?

Mr. Holmes: They are not allowed to write off any of it, as things stand.

The Acting Chairman: That is, they are not allowed to write any of it off against their dental income.

Mr. Holmes: That is right, sir.

The Acting Chairman: Under the White Paper what will they be allowed to write off against their dental income?

Mr. Holmes: They will be able to write off 20 per cent per year on a reducing balance basis.

The Acting Chairman: In other words, they would be allowed to take 20 per cent diminishing balance of the $100,000 against their dental income.

Mr. Holmes: Right, sir.

Mr. MacKenzie: That is not quite correct, because it is only with respect to allowable expenditures. It is not 100 per cent of the money spent.

The Acting Chairman: Then what part of the $100,000 would be allowable?

Mr. MacKenzie: We are not clear about that. It has not been spelled out in the brief.

Mr. Holmes: So far as the drilling situation is concerned, they can deduct the whole thing. In that particular case it is clear.

The Acting Chairman: I suppose the purchases of leases might not be deductible.

Mr. Holmes: Yes, they would be deductible. Let us not confuse this with earned depletion, Mr. Chairman.

The Acting Chairman: I realize we are talking purely about exploration and production expenses.

Mr. Holmes: Exploration expenses would be the purchases of leases, the drilling of wells, seismic work and things like that.

The Acting Chairman: To all intents and purposes 20 per cent of the $100,000 on a diminishing balance each year could be written against their dental income.

Mr. Holmes: Yes, sir.

The Acting Chairman: However, what they could do is incorporate a company, take the common shares out for their $100,000 and, if they hit a dry hole, they would sell the shares of the company for $1 each.

Mr. Holmes: Right.

The Acting Chairman: They would then show a capital loss, which, under paragraph 3.31, is deductible from their income, which would be achieving an intention the White Paper does not have. You are saying that the White Paper ought to have the intention not to make these expenditures deductible as they are in the United States.

Mr. Holmes: Yes. I am saying that we should have them as a straight deduction rather than either the 20 per cent or by going the route we mentioned here, which I think would be classed as a loophole in the new act if the White Paper was implemented as written.

Senator Gélinas: Mr. Chairman, I believe this company owns petroleum and natural gas and other mineral rights in the provinces of Ontario, Manitoba, Saskatchewan and Alberta, as well as in other areas of Canada. Are any of their properties in Canada in the course of being developed at the present time?

Mr. MacKenzie: Yes, sir. We have oil leases in Alberta which we are currently developing; we have a mining situation in British Columbia which we have just recently put on production and on which we are doing additional exploration and development work; and we have some gas leases in Alberta on which we are doing some development work.

Senator Gélinas: You state in your brief that notwithstanding the difficulties encountered in the formation of a separate Canadian entity the company has recently taken steps to list its shares on the Toronto stock exchange. Would that be shares of the parent company?

Mr. MacKenzie: That is correct.

Senator Gélinas: The parent company is based in Denver.

Mr. MacKenzie: That is right.

Senator Carter: Are you in the same situation as the International Utilities Company that presented its brief this morning? Would you be forced to incorporate in Canada?

Mr. Duffy: Senator, our position with respect to incorporation in Canada is complicated by the land holdings we presently have in the Northwest Territories. There

would be no need for us to form a Canadian corporation and incorporate here, if we did not wish to do so, until such time as we went to lease—as we converted the federal lands we own in the north at the present time in permit form to lease, in accordance with the regulations laid down by the Department of Indian Affairs and Northern Development. At that time it will be mandatory that those permits be held by a Canadian corporation.

The comments to which you are referring, sir, are part of a plan which we began to institute, not only to comply with the minimum restrictions applied to us by the Department of Indian Affairs and Northern Development, but also as an attempt to respond more fully to the apparent wishes of the Government for us to be good Canadian corporate citizens. It was our intention at that time to incorporate initially a Canadian company, transfer the total Canadian assets of King Resources Company into that corporation and make a portion of the shares available to the Canadian public.

This whole procedure was frustrated by a number of factors, the United States Government tax regulations being one of them. It was ultimately brought to a conclusion by the introduction of the White Paper, which would have placed us in a very difficult situation.

The Acting Chairman: Could you tell us why?

Mr. Duffy: I would be pleased to tell you when I finish the thought I was developing.

In direct answer to your question, in order to begin to comply with the minimum regulations as set down by the Department of Indian Affairs and Northern Development, we have taken the step of applying for listing on the Toronto stock exchange. We have also prepared a corporate vehicle of Canadian legislation into which ultimately our northern permits will be transferred.

We will be able to do this and still not be severely stricken by U.S. taxation, because we would be able to consolidate with our parent company the income and expenditure of that Canadian company for U.S. tax purposes. We would only be able to do this with respect to our federal land holdings.

In answer to Senator Everett's question, the problem that we face is that the introduction of the White Paper would have left us in a position where we had a Canadian corporation which owned the most, we hope, dramatic Canadian assets of King Resources Company. It would have been a closely-held corporation in the sense of a solely-owned subsidiary of our American parent.

The situation would have been that stock in that corporation would be less attractive because of the full taxation of capital gains. If we went public with the Canadian public, the shareholders, which would be largely King Resources Company, would have been faced with a deemed realization every five years on any capital gain in that corporation, which we would have expected to have been large.

The Acting Chairman: And that deemed realization would not have been deductible on American taxes.

Mr. Duffy: That is right. We are left now in a position where we can only minimally comply with the letter of the regulation. That is to put our assets in a Canadian corporation as a wholly-owned subsidiary of the parent and list the parent's shares in Canada.

The Acting Chairman: You make reference in your brief to the suggestion that such a company should be classed as a widely-held corporation. Taking into account the deemed realization provisions, why would you suggest that?

Mr. Duffy: We were attempting to identify and solve various problems in this connection. There was another problem which developed as a part of this process.

The United States Government was prepared to allow us to place only our Arctic lands in a Canadian corporation and allow consolidation, because it was in effect required by the laws of an adjacent country. This would have segmented the assets of King Resources Company, being everything else in Canada that was not federal lands and did not have to become a Canadian corporation. Those federal assets would have been broken apart.

This defeated several of our purposes. It splintered our assets, for a start. It would also have made one or other of these two groups of assets very difficult to operate efficiently.

As a method of surmounting that problem it was proposed that we transfer all our Canadian assets into an American corporation which would conduct its business solely in Canada, be managed by Canadian management, have a majority of Canadian directors and thus qualify as a Canadian resident corporation.

The Acting Chairman: Would this then qualify for the integration feature?

Mr. Duffy: We could then handle our U.S. tax problem and our Canadian labour problem in so far as the Department of Indian Affairs and Northern Development is concerned. We could consolidate and behave as though we were a Canadian company, as was mentioned this morning with respect to International Utilities Limited.

The Acting Chairman: Would you list that company on a Canadian exchange?

Mr. Duffy: Since it is a foreign corporation still—the original intention was yes, we would list that company on a Canadian exchange.

Mr. Holmes: There would also be a share offering to the Canadian public.

Mr. Duffy: Yes, a public offering and a listing. However, that would be a widely-held foreign corporation under the White Paper terms, with the disadvantages that naturally follow.

Senator Benidickson: It would be in the same position as International Utilities Limited, who explained their position this morning.

Mr. Duffy: Precisely.

Senator Benidickson: Except that you differ from International Utilities Limited in that your actual shareholders would not be as Canadian as they presented theirs.

Mr. Duffy: That is right; this company would be created to have its affairs in Canada conducted by Canadians, but it would be controlled in the United States.

Senator Benidickson: Yes, whereas this morning they presented their situation as one in which the majority of the equity, 68 per cent equity shares, was owned by Canadians.

Mr. Duffy: Our problem is analogous; our defence is a little different.

The Acting Chairman: Does that answer your question, Senator Carter? Are there any other questions along that line?

Perhaps we could then move to the end of your brief, at page 43, in which you make a comparison between Canadian and United States individual tax rates.

As you are an American-based company it would be rather interesting to the committee if you went through this comparison and told us something about it.

Mr. Holmes: We requested Arthur Anderson, our auditors, to prepare a comparison of two individuals, one a Canadian in Calgary, Alberta, and one an American in Denver, Colorado, both in similar circumstances.

The assumptions are listed in Exhibit B(3). They both own their own homes and are paying off mortgages. They are both married with two children aged six years and twelve years. They make certain charitable contributions, which are identical, medical insurance premiums, and so forth.

The tax has been calculated in the first instance as the present tax law applies. This is A on Exhibit B(1). Individual B is under United States tax laws after full implementation of the Tax Reform Act of 1969.

The Acting Chairman: We are now dealing with Exhibit B(1); is that correct?

Mr. Holmes: Exhibit B(1), yes sir, under the Canadian tax rules after full implementation of the White Paper proposals for tax reform. Therefore, you see that in the second case an individual with an income of $10,000 a year living in Denver would be taxed $1,252, and if he were living in Calgary he would be taxed $1,714.

The Chairman: Up to a gross income of $30,000 where the tax payer living in Denver, Colorado, would pay $6,339 as against a taxpayer in Calgary, Alberta, paying $10,634. This indicates that the Canadian tax in that case is 68 per cent higher than the comparable American tax.

Mr. Holmes: That is correct, Mr. Chairman.

The Chairman: Are there any questions on that part of the brief?

Senator Hollett: Does that include all taxes?

Mr. Holmes: Yes, this is earned income only and it includes all taxes with the deduction for family allowance.

Senator Carter: This morning you were talking about capital gains and you also said in your brief that if we introduced capital gains in Canada we should not be more severe than in the United States. I would like to get your idea as to whether or not we should have two different rates, one for the speculator—the short-term capital gain—and

the other for the long-term investment. Would you draw a distinction between these?

Mr. MacKenzie: I will endeavour to answer your question, and I would like to make some comments which relate to it.

The Chairman: Perhaps you could deal with that section starting on page 19 which is headed "The treatment of capital gains".

Mr. MacKenzie: I do not think that anywhere in our paper it is shown that we support the idea there should be a capital gains tax at all. Some of us do and perhaps some do not. I am one who does not. Remember, we are free citizens as well as representatives of King Resources. We are speaking with two hats on, the company hat and our own individual hats.

The Government in its White Paper proposals states that fairness in taxation is arrived at considering the two principles. One was that people under similar circumstances should pay similar tax. I think there has been a jump to assume that similar circumstances means identical income, and that identical income should be defined as "a dollar is a dollar" and that therefore a fellow making capital gains should be taxed the same as an individual who makes it in some way. We do not feel that similar circumstances should be misinterpreted as a quality of income, but rather as similarity in the manner in which the income is obtained. We are in agreement with the expression and the wording of the principle, but we are not in agreement with the form of reasoning that has developed out of it, which is equated to equality of income.

I find it very difficult to stand in front of you and propose the type of capital gains you should have, or what should be done. The reason I am against a capital gains tax is that we need to encourage risk taking on capital formation in this country. I think this will tend to discourage it. I am not for capital gains at all, but if we must have it then I am concerned as to its effect on the foreign investor when he is faced with paying a tax on his capital gains based on ordinary income.

We can go further and say that the Government is unhappy because certain speculators seem to get away with a great deal. I think that is part of your risk of living.

Senator Carter: I am unhappy about the land speculators who buy property and raise the cost of housing by 20 or 30 per cent. That sort of thing should be discouraged. They should be penalized.

Mr. MacKenzie: This is a matter of opinion.

The Chairman: I might interject to point out that the sort of speculator you talk about, Senator Carter, is taxed today at full income rates.

Senator Haig: If it is his business.

The Chairman: Even if it is not his business. His intention was merely to buy the property in order to sell it at a profit. Even though that is not his principle business it still is an adventure in the nature of trade so far as the Tax Appeal Board and the courts are concerned. He will be taxed at the full income rates.

If there were to be a difference in rates between capital gains tax and ordinary income under the White Paper, I suspect the same test would apply. The poor speculator is also going to pay income rates.

Mr. MacKenzie: Thank you for elaborating on that. There is the question of buying securities and how long one holds them, and there is the intention of the purchaser as to whether he buys them as an investment or as a speculation. The United States deals with this differently. There are two sets of circumstances. If we are going to have a tax, possibly something along those lines would be more meaningful. As it is proposed, I consider it punitive. I would appreciate it if these other two citizens with me here today would comment, because we do not always agree.

Mr. Duffy: There is room for distinction between short-term speculation and the long-term gain. I am in general agreement with Mr. MacKenzie's comment. Looking at some of the projections that have been made for the need of capital, particularly in order to develop our northern resources, whether we can afford a capital gains tax at this time is questionable. In the event that one is instituted I think there should be a distinction between short term and long-term gain. The long-term gain should be taxed at a rate no more punitive than that in the countries with which we compete, and the short-term speculative tax rate might well be more punitive.

Senator Gélinas: You might call that short-term investment too.

Mr. MacKenzie: Yes.

The Chairman: Are there any questions on that point?

Senator Carter: One of the witnesses this morning introduced a different idea with respect to taxing small business. I would like to get the reaction of these witnesses to it. As I understood it they would tax small business 50 per cent or at the regular corporation rate, but the Government would collect only 21 per cent. The other 29 per cent would be put in a tax reserve which they could hold as non-taxable unless they paid it out in dividends. If they used it to pay it in that form, in dividend, then they pay taxes on it. I wonder if you could give your reaction to that.

Mr. MacKenzie: My reaction is that it tends to solve one of the areas of concern that we have had, that is, the great difficulty placed by a small company in the initial part of life, in getting enough capital to operate. That proposal does tend to alleviate that problem, but it does not solve the whole thing that we have right now, because it does not create the incentive to go out and take a risk in forming a business on your own, as the present existing ones. I think we are changing a good thing for a bad thing and that does not make it quite so bad.

Senator Carter: The advantage of that is that you do not need to define a "small business". That is part of our problem, I think.

Mr. Holmes: Mr. Chairman and Senator Carter, I think it might create other problems of its own, in the matter of undistributed income and things like that, which would tend to get blocked up. In other words, I think there would be easier ways of getting an incentive to small businesses, something that would be just as meaningful but would require less in an administrative chore to handle.

The Acting Chairman: Can you give us some indications of what you could suggest?

Mr. Holmes: As you know, we have not made any specific suggestions. We have said that the 21 per cent of the first $35,000 of income has been a great incentive for small businesses. We appreciate the problem involved. That is, that everybody gets it and it is an advantage for large businesses that do not need it. But I would say that there are a dozen or fifteen different people in this room that, if they were all asked that question, could come up with fifteen different way of handling it. I myself would prefer something such as they have now, the low rate on the first $35,000, defining the small businesses as anything with net profits under $100,000 and then some sort of a notch provision over that that would eliminate the 21 per cent, say, after you have passed the $130,000 or $120,000.

Senator Isnor: Following Senator Carter's questions, that would have the retainer as a liability, and that would not help his rating very much with the bank, if he wanted to borrow.

Mr. Holmes: That is a very good point, senator.

Senator Cook: It would tie his liability, and the Government would have first claim on it. If it was a question of his credit it would not do him much good from the point of view of capital. It would help him to carry it on his books, this tax reserve, and in the event of insolvency, the Government would have the first right.

The Acting Chairman: As I gather the suggestion now being made by Mr. Holmes, it is that for all companies under $100,000 they would get the low rate and they would be free to dispose of the money in any way they want, whereas under the present system, above $100,000 would be a notch provision and the tax would gradually disappear as net income. I think you are referring to the suggestion that Senator Carter is dealing with.

Senator Cook: As was Senator Isnor.

The Acting Chairman: Yes.

Senator Isnor: One of the advantages of the system is that it would help the person, it would help the merchant. I cannot see where it would help him so very much if he is carrying a greater liability.

Mr. Holmes: I do not think it would, and I was not in favour of that, senator. You have mentioned one good reason which I had not mentioned before. I mentioned the matter of the problems of undistributed income which I think would develop from a plan such as that one that was mentioned this morning.

The Acting Chairman: And for those two reasons you are opposed to that plan?

Mr. Holmes: That type of plan, yes.

Senator Aseltine: I do not think it would work.

The Acting Chairman: Are there any further comments on the low rate of tax? I have one, which is at the bottom of page 30. It is the first time we have seen this suggestion, which states as follows:

> If any tax changes are to be made in this regard...

Referring to the low rate...

> ...it should be to allow those professions which cannot incorporate to have their operations treated as incorporated businesses for tax purposes.

Would you care to give us some details on that?

Mr. Holmes: Yes, sir. As you know, most people, if they wish to incorporate, can incorporate and take the advantage of the low rate. There are certain of us who cannot incorporate—lawyers, doctors, dentists, chartered accountants. They have to practise as partnerships or individuals. In a situation such as that, I think that these people should be allowed the advantage of the low rate and that their firm income, their legal income or accounting income or medical income, should be taxed at that low rate.

Senator Carter: Do these people need to build up capital reserves? Take an architect, for example? I can see that a dentist would.

Mr. Holmes: I think a lawyer would have to do so, too, to handle his receivables. I know that a chartered accountant would have, to handle his receivables and work in progress.

The Acting Chairman: And you think that would be possible, do you?

Mr. Holmes: Yes, Mr. Chairman, I believe that could be fairly simply devised.

Senator Cook: If you leave it at the 21 per cent preferential rate and put 51 per cent on the other—1 per cent on the executive rate would take care of this, and 2 per cent on the basic, leaving the advantage towards small business.

The Acting Chairman: Yes, I think that is true. You are a lawyer, Senator Cook. Would it be possible, do you think, to devise a system whereby a legal firm, while still continuing to be a partnership, could for tax purposes be treated as a corporation so that it could enjoy the low tax rate on its income? Do you think that would be possible? That is what the witnesses are suggesting?

Senator Cook: I do not see why not?

The Acting Chairman: What would you do with retained income?

Mr. Holmes: I think you would have to have the same rules apply all the way through. When retained income is taken out by the partners, I think you would have to allow them the 20 per cent tax credit—in other words, treat this as dividend.

The Acting Chairman: I can see all sorts of complications. It is a very novel suggestion but I can see tremendous complications in trying to put it into operation.

Mr. Holmes: I do not think it would be very complicated to operate.

The Acting Chairman: Would you care to do a paper on this for this committee and file it?

Mr. Holmes: I would be pleased to do so, yes.

Senator Cook: All you would have to do would be to assume a capital allowance all through the year.

Senator Benidickson: It would be assumed, then?

Senator Cook: It would be deemed.

The Chairman: If it did that, there would be little argument then for the low rate of tax being necessary for the expansion of the partnership—if all it was going to do was pay it out every year. The value of the lower rate of tax, as I understand it, is that it is retained by the small company, in order to expand.

Senator Benidickson: One of the reasons advanced by the authors of the White Paper for eliminating this low rate of tax is that they say it is subject to abuse by people who are perhaps in a position to incorporate. They might incorporate and include in their corporate shell income that is entirely investment income and get a low rate on it. That is one of the reasons they have suggested that the low rate should not be continued.

Mr. Holmes: My only comment on that, senator, is that in the case that I am suggesting it would be restricted to the legal income, the accounting income or the medical income of the firm. If there was any investment income it would have to be in the hands of the partners.

The Acting Chairman: Honourable senators, Mr. Holmes has agreed to file with the committee a study on that point. Is that agreed?

Hon. Senators: Agreed.

The Acting Chairman: Now, you have dealt with the low rate of tax. Do you feel that you have dealt with the deemed realization and quinquennial valuation sufficiently?

Mr. MacKenzie: I believe, sir, from what I have read since forwarding this brief to you, that this matter has been covered quite extensively by your committee. If we can help in any way by elaborating on our ideas in the brief we would be glad to answer your questions.

The Acting Chairman: I gather the burden of your idea has already been dealt with by Mr. Duffy in regard to the problem of King Resources incorporating or not incorporating in Canada and perhaps having to split up its affairs.

Mr. Duffy: That is a real burden that is most obvious to us and we felt it constituted a good vehicle with which to discuss it with you. We have not covered the aspect of deemed realization of capital gains in the event of transient managers coming and going into and out of the country, or the problems associated with people seeking to retire to a more hospitable climate. That is an area of equal personal concern to us, and I am sure Mr. MacKenzie would like to elaborate on that.

Mr. MacKenzie: Honourable senators, I am a Canadian, naturalized, born in Barbados in the British West Indies. My family has some holdings in Barbados, which, by reason of the climate there, have become of some value through the tourist industry. Some years from now I might like to return to the place of my birth. I am not at all pleased at the prospect of having any asset realization that has occurred there being taxable in Canada. I do not feel I owe it to Canadians in any way to pay that asset appreciation that I acquired out of this country towards the maintenance of this country. Actually, if there was anything to be paid out of that asset realization I would prefer to pay it where it is needed more—in that underdeveloped country where I came from.

Forcing people to retain residence and citizenship under the penalty of deemed realization of assets in and out of this country on leaving the country is to me a most unpleasant circumstance. I should think that any country—certainly a country that I have adopted and that has also adopted me—would want me to wish to preserve my citizenship and residence because I want to and not because I would be penalized by leaving. That is why I used the words in this brief that this is the sort of thing that is typical of totalitarian governments in their attempt to maintain residence of people who want to go abroad to more attractive sociological climates. We have the Iron Curtain around Russia, which includes the Berlin Wall; we have the bamboo curtain in the Orient, and now we have a White Paper tax curtain. It is entirely revolting.

I do not know if I have expressed myself strongly enough. I hope I have not been too reticent in expressing my concern.

The Acting Chairman: At least the curtains are being made of less and less durable material.

Senator Isnor: As a Canadian, I would say you have expressed yourself too strongly.

Mr. MacKenzie: Would you elaborate on that, please, sir?

Senator Isnor: You have adopted this country as your country for the time being only, I should think. You are making a good living. You hope to put savings aside for the future and then you do not want to pay for the privilege of doing so.

Mr. MacKenzie: Sir, I deeply regret that that is the interpretation you place upon my words.

Senator Isnor: I could not do otherwise.

Mr. MacKenzie: Sir, I said, with respect to the asset appreciation that occurred of personal holdings of mine in the place that I left, that I did not feel such asset appreciation should be taxable in Canada. I have always been more than willing to pay my fair share. I fight—and that is why I am here—as to what I think is fair. And this is the opportunity we have in this country, because it is free. I am here in the country that I have adopted and which has adopted me; I am appearing in this committee because my concern is for Canada and Canadians and my children who are Canadians.

Senator Everett: I think what Mr. MacKenzie is saying, Senator Isnor, is that he has

assets in Barbados; he feels that, by the operation of the White Paper, if, as and when he wishes to return to Barbados, he will have to pay a capital gains tax on the increase in value of the assets he holds in Barbados. He is not objecting to paying a gains tax on the assets that he has accumulated in Canada. Is that a correct understanding?

Mr. MacKenzie: That is entirely correct, sir. I am not objecting, if that is a law that is passed in this country; naturally, I am fighting it, but if that is the law, and I am a Canadian, I will abide by the law and pay the obligations that the majority of the people in this democracy have decided should be our payment. But I question the fairness of that asset appreciation in Barbados being taxable in Canada.

The Acting Chairman: That is only with respect to the assets in Barbados. You have no objection to the assets you have accumulated in Canada being taxed by way of deemed realization when you leave.

Mr. MacKenzie: I have no objection, if that is the law; but I certainly do object to that becoming the law. That is why I am here fighting it.

The Acting Chairman: You go further than that: you object to the whole capital gains tax.

Mr. MacKenzie: Yes. I think it will hurt us.

Mr. Duffy: At page 26 of our brief we make our joint position clear in respect of deemed realization. We say simply that, because we firmly believe that taxation on the basis of deemed realization is grossly unjust, we recommend that there should be no deemed realization of capital gains under any circumstance.

The Acting Chairman: Let us deal for a moment with a person who really wants to leave Canada for good. If there is to be a capital gains tax in one form or another, does he not then escape that tax by changing his residence?

Mr. Phillips: I am not sure, but the United States has a capital gains tax and they have citizens who leave and live in other countries. I believe they are required to pay United States tax if they want to retain their citizenship. Up to recently and even now they treasure that citizenship in the most part.

The Acting Chairman: Is there a deemed realization in the United States for those who change their domicile or residence?

Mr. Phillips: No, there is not.

Mr. Holmes: No, there is none, but they have a different concept. We tax on residence and they on citizenship. Therefore they are liable to U.S. tax no matter where they move to in the world, whereas a Canadian who is out of the country 183 days is not classed as a resident and therefore does not pay tax.

The Acting Chairman: Let us deal with the residence form of taxation. Would it not be a means, if capital gains tax is imposed on Canadians who maintain their Canadian residence, of certain Canadians escaping a tax that is imposed on all other Canadians merely by changing their residence to the Bahamas or some other country? Would that not be discriminatory?

No other brief we have received so far as I recall has found fault with that aspect of the White Paper. They have found fault with the aspect which says that a person coming from a foreign country for a short time in Canada and returning to the foreign country may well have a deemed realization on his assets. Also that a Canadian going to a foreign country in connection with his business, who intends to return to Canada, would have a deemed realization.

They feel that certain amendments should be made to the proposed tax in order to avoid that.

However, so far as I can recall this is the first time I have heard that if we are going to impose a tax on gains someone can escape it by leaving the country.

Mr. Duffy: First of all, I agree entirely with the points that you have just made and the series of objections that others have presented before you.

Our concern is to prevent a comparatively small number of people from having the opportunity to avoid taxation by leaving the country for whatever reason and for whatever duration.

We speak of having all of the person's assets appraised and taxing him on the basis of a realization which would be difficult to administer, expensive to accomplish and could be in a number of circumstances extremely punitive in the sense that the

assets a person had accumulated might be rather limited and he would have to find the resources somewhere to pay the tax on the realization.

I might prevent him from going to California to spend his twilight years, or whatever the case might be. Surely there is a better way to handle this problem. The focus might be on a security basis, stocks and bonds, because this represents a liquid asset that the person in question can conceivably dispose of in order to cover part of his expenses.

What I am saying is that the proposal is too encompassing and too massive.

Mr. Holmes: You are quite right, Mr. Chairman. I agree with you that there could be a large loophole here.

You are faced with the situation where someone, for health reasons, is told by his doctor that he should move to a warmer climate. If there is a deemed realization we may not have the wherewithal to live in that climate.

There could be a change in a situation such as that to tax a person on citizenship rather than residence. A number of changes could be made in this area which would close the loopholes so that a person just cannot leave the country without paying capital gains tax, assuming one is enacted.

The Acting Chairman: I can see how the deemed realization does create an enormous amount of hardship on sick people and those retiring.

Mr. Phillips: It also seems to me that it would create a great deal of hardship on the law-abiding citizens of the country. I do not know how this could possibly be enforced. The people who do not respect the law would just leave and transfer their assets out of the country, saying they are going on vacation. However, they do not intend to return.

So saying that that is a loophole, we are going to use this massive steam roller to crush this small problem. You are only crushing the ones who intend to abide by the law anyway.

It seems to me to be highly impracticable and inequitable.

The Acting Chairman: You are saying that at best it is an unendorceable law.

Mr. Phillips: It seems that way to me.

Senator Cook: All you have to do is check all their assets before the time comes for travelling.

The Acting Chairman: That is true. Are there any other questions, honourable senators?

Have you made all the points you wish to make, or do you have any further comments on your brief?

Mr. Phillips: I would appreciate the opportunity to make one general comment. The whole thrust of this tax reform is difficult to assess for people such as us.

We have limited experience and limited facts. We work in the west, my background being primarily geology. We assess these proposals in the light of what they will do to our lives and our company.

I used the word earlier that it would be ruinous to our company.

I do not mean to the present position our company holds, but our aspirations in this country, which are to search for and develop natural resources and to allow and encourage Canadian participation at various stages.

We cannot do this the way this looks. The whole shift is one from autonomous democracy, where you have an opportunity for citizens who see a need and take spontaneous action and risks to fill it.

If we move capital away from those individuals and put it into the hands by transfer of wealth, of the federal Government, even if they have a development corporation, we will have fewer small businesses. It would not be worth taking risks and we would have more and more centralized decisions.

Historically this has resulted in a situation of bureaucracy and red tape. I believe that the competitive environment, risk-taking, courage and individual opportunity have made this country. I do not think that we should too quickly be discouraged from this because of a concept of equity and fairness.

Certainly we desire equity and fairness, but it also involves giving individuals opportunity.

The whole thrust of this endeavour is changing that and changing it drastically. As a Canadian I am unhappy with it.

Senator Cook: You are not alone.

Mr. Duffy: I have a brief closing comment. I am concerned that our Canadian posture is

sometimes confusing. We, of course, deal with an American company. We were fairly successful in convincing our management in the United States that it was highly desirable for us to Canadianize our operation in the truest sense of good corporate citizenship, and not simply comply with the letter of the law.

Our politicians and business leaders have on many occasions suggested to foreign companies that they should incorporate here in Canada and make shares available to the public and be responsible citizens. Certainly our posture to foreigners has suggested that we would be very happy if they would comply with our wishes in this regard. Yet, there seem to be thrusts in the White Paper that would make this very difficult or might even penalize those who do so. We are facing this kind of a problem now.

I wanted to say this to you because it seems that some government departments have different points of view, and they take different steps to achieve their own end. This group is one that I think is capable of an over-view to a substantial degree about our sometimes confusing attitude. You may wish to use our own corporate problem as an example, but I would strongly recommend that you consider ways in which you might make some contributions to clearing up the confusing situation that we seem to be generating abroad as to what we want foreign companies to behave like when they live here.

Mr. Holmes: Mr. Chairman, I would like to make one further statement. We have spent considerably more money on exploration and development work than we have recovered that to date. While we have been operating in Canada since 1961, we have not paid federal or provincial income taxes. However, during that period we have paid a total of some $4,400,000 in crown oil deeds to the various western provinces, lease acquisition costs, municipal taxes, and things such as that.

The Chairman: Are there any further questions, honourable senators? If not, on your behalf I think Mr. MacKenzie, Mr. Duffy, Mr. Holmes and the King Resources.

The committee adjourned.

APPENDIX "A"

SUBMISSION

of

Hudson's Bay Oil and Gas Company Limited

with respect to the

WHITE PAPER

entitled

Proposals For Tax Reform

(Issued November 1969)

March 1970

SUMMARY
HUDSON'S BAY OIL AND GAS COMPANY LIMITED
SUBMISSION CONCERNING WHITE PAPER ON PROPOSALS FOR TAX REFORM

Hudson's Bay Oil and Gas Company Limited (abbreviated as HBOG) appreciates the aims of the White Paper, but the proposals to achieve these aims are radical and untested and will no doubt have unanticipated or deterimental economic results. Most of the objectives can be achieved with minor changes to the existing tax system and others by gradual implementation.

Income tax reform cannot be considered in isolation; tariffs, business risks, regional development and other taxes or contributions to governments must also be taken into account. The White Paper refers to other changes made, or to be made, in items such as estate taxes, rates of capital cost allowance or sales taxes which may produce serious results when combined with the proposals for tax reform. Therefore, no major changes should be made without simultaneously considering the changes contemplated in the other areas of national revenue.

HBOG strongly opposes any proposals which will have a detrimental impact on the Canadian economy and its extractive industries. The comments and recommendations included in our submission on the proposed tax reforms are discussed in six sections which are briefly summarized as follows.

I Proposals Concerning the Petroleum Industry

HBOG agrees with the principle of earned depletion but the cost of mineral rights should earn depletion and developed properties held on November 7, 1969 should be exempt from the earning provisions. Calculating the depletion incentive at 20% of gross income with the amount claimable restricted to 33 1/3% of exploration and development expenditures, including mineral rights, would eliminate the disincentive inherent in the proposed system and correct other inequities and inefficiencies. The White Paper proposals will have to be modified in order that the depletion incentive flow through to the shareholder because the integration procedures have the effect of taking away 75% or more of the benefits of depletion from the shareholder.

II Taxation of Capital Gains

Greater equity in taxation will be achieved by including capital gains in the tax base, but the proposals as stated to tax unrealized gains are inequitable. To recognize the significant difference between ordinary income and a capital gain, the latter should be taxed at rates substantially lower than those applied to ordinary income, with a maximum rate of 25%. Capital losses should be deductible in a similar manner. Taxing of capital gains requires more liberal averaging provisions which should be the same for all taxpayers irrespective of their occupation.

III Corporations and Their Shareholders

The White Paper's definitions of widely and closely-held corporations form a totally inadequate basis for formulating taxation policies. All corporations and their shareholders should be taxed in a similar equitable manner with respect to dividends received and profits made on the sale of shares.

The proposals to integrate personal and corporate taxation are not in the best interests of Canada because they will prejudice the "low-tax-paying" growth companies and have negative effects on financing. We view the proposed crediting procedure as impractical and costly due to the administrative and tax assessment problems. Little, if any, change is necessary with the present system and most of the desired integration results could be achieved by relatively minor changes in the dividend tax credit system. If required, a higher dividend tax credit could be given to lower income taxpayers.

IV Economic Effect of the White Paper

HBOG is concerned with the inflationary potential inherent in the proposal to transfer large sums of money from the traditional savers and investors to the Government and the low income group. As the resulting erosion of the value of the dollar is compensated for by rising wage rates, many of those who are relieved of tax burdens will gradually reassume them. A net reduction in savings will cause reduced rates of growth and development of the Canadian economy as well as place upward pressure on interest rates and necessitate increased reliance on foreign investment. Limitation of Government expenditures to fit reasonable revenue expectations should be an objective rather than to tailor a tax system to meet spiralling expenditures.

V Effects of the White Paper on Financing

We are most concerned about each of the White Paper's proposals that will have a negative effect on the accumulation of Canadian investment capital and the attraction of investment capital to the resource industries. Canada will continue to require large amounts of capital to develop its economy. With inflation and taxation removing substantial amounts of capital from Canadian savers and investors, financing our industrial growth will become substantially more difficult under the White Paper proposals. These factors combined with high interest rates and a bias against the high risk petroleum industry would create very real financing problems even for a strong, emerging company such as HBOG.

VI Other Proposals for Changes in Taxation

This section discusses briefly other proposals which should be included in further considerations of the tax reform. Such items include the following:

1) The Canadian need for highly trained and motivated people.
2) True tax reform requires equal rates of taxation in all provinces as well as a maximum personal rate that is no greater than the corporate tax rate.
3) The new depreciation class of "nothings" should include the costs of rights-of-way, commissions and other disallowed financing expenses, bond discount, trademarks and corporate symbols, mineral rights acquired prior to 1962, and line-fill in pipe lines.
4) Reasonable expenses for entertainment and similar activities are legitimate business costs.

SUBMISSION

of

HUDSON'S BAY OIL AND GAS COMPANY LIMITED

with respect to the

WHITE PAPER

entitled

"PROPOSALS FOR TAX REFORM"

(Issued November 1969)

MARCH 1970

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LIST OF EXAMPLES

INTRODUCTION

Hudson's Bay Oil and Gas Company Limited (abbreviated as HBOG), is pleased to offer its comments on those sections of the White Paper which may have a material effect on Canada and its citizens, and on the Company, its shareholders and employees. HBOG commends the Government for offering its "Proposals for Tax Reform" to Canadians for examination and discussion before legislation is enacted. Many Canadians will have difficulty making constructive suggestions in response to the Government's request for public discussion because tax reform is such a complex subject. We hope that the Government will give serious consideration to all submissions concerning the White Paper before implementing any substantial tax reform.

HBOG is primarily engaged in the exploration, development and transportation of petroleum and related products and ranks approximately fifth among Canadian oil and gas producers. A description of the Company and its operations with statistical data covering the past five years is detailed in Exhibit I together with comparable data for the industry. It is evident from this exhibit that HBOG's operations constitute a significant part of the total industry exploration and development activities and therefore may be considered representative of this segment of the petroleum industry. A copy of our recently published Annual Report for 1969 is included as an appendix to this submission.

It is impossible to prepare an in-depth submission on the proposed tax reforms without the benefit of further information because numerous provisions in the White Paper need clarification. We hope that the

1.19 Personal income taxes are the most important single source of government revenues, making up $7.8 billion of the $27.6 billion all governments expect to raise in revenues this year. Their central position in the revenue structure is appropriate. More than any other tax the personal income tax can be carefully adjusted to the income of the individual and the circumstances which affect his ability to pay, such as family responsibilities and unusual expenditures or expense obligations. To see that the whole tax system is fair, we must ensure that the income tax remains the main tax levied on Canadians. It should be given priority in the tax reform program. Reform of the sales tax is less urgent and can be undertaken after action on the proposals in this paper.

5.14 The system has without doubt proven easy to comply with, and has caused far fewer difficulties between taxpayer and taxgatherer than the more usual "straight-line" system that preceded it in 1948 and earlier years. One of the reasons that it works so well may be because, on balance, the rates tend to be on the generous side. This generosity has acted as an incentive to taxpayers to modernize and improve their business facilities, but naturally at some cost in government revenue. The royal commission did not recommend reductions in depreciation rates. Perhaps for that reason, the rates were not generally an issue in the public debate on tax reform that has taken place over the past two years. Nevertheless some have suggested that they are too generous, and the government believes that after 20 years of the system it is time for a review. However, depreciation is an important aspect of the tax system and taxpayers should have an opportunity to put forward their views and experience before major changes are considered. Therefore, the government intends in due course to invite briefs on the system and rates of capital cost allowance.

The Aims of Tax Reform

1.6 A number of goals and standards have guided the government in its approach to reform. They include a fair distribution of the tax burden based upon ability to pay; steady economic growth and continuing prosperity; the recognition of modern social needs; widespread understanding of and voluntary compliance with tax laws, combined with enough detail to block loopholes; and, finally, a system that can and will be used by the provinces as well as Canada.

Government will publish additional data clarifying its proposals and allow sufficient time for a thorough review. We believe that an equitable taxation system will evolve only if the proposals are reviewed thoroughly by all interested parties. The proposals suggest that there will be a reform of
1.19 the sales tax provisions in the Excise Tax Act and a review of the capital
5.14 cost allowance system, but no indication was made with respect to changes in tariffs. These areas of national revenue are so inter-related that there should be no major changes in one of them without simultaneously considering the changes contemplated in the others.

HBOG appreciates the objectives of the White Paper proposals
1.6 and agrees generally with the aims expressed in paragraph 1.6 which appear to be reasonable and logical. However, the measures suggested to achieve these aims are new, far-reaching and untested and we are concerned with their potential adverse repercussions. The necessary tax relief for low income persons combined with the suggested requirements for more Government revenue places undue constraints on other equitable tax reform and weakens the proposals for complete equity.

We believe that most of the objectives can be achieved with minor changes to Canada's existing tax system and others by a gradual implementation of new ideas. Limitation of Government expenditures to fit reasonable revenue expectations should be an objective rather than to tailor a tax system to meet spiralling expenditures.

HBOG strongly opposes any proposals which will have a detrimental impact on the Canadian economy and its extractive industries. We believe

that the transfer of an additional tax burden on the nation's traditional savers and the taxing of capital gains at full marginal rates are incompatible with Canada's goal to expand economic growth and to increase Canadian ownership of its industries. Canada's tax system must encourage rather than discourage further capital accumulation by Canadians to develop fully an economy which is based significantly on natural resources. Any deficiencies of Canadian capital will, if necessary, continue to be supplied by foreign investors whose favourable view of the Canadian economic and investment climate must be maintained. The White Paper proposals appear ill-timed in view of the fact that investment by Canadians in our enterprise is considered insufficient particularly in the extractive industries. The present incentives which have not proved completely successful in attracting Canadian investment would be materially reduced under the White Paper thus aggravating an unsatisfactory situation. We are quite concerned that the White Paper proposals will reduce the quantity of capital attracted to the natural resource industries at a time when the needs for such capital are increasing to meet an almost certain increase in demand for our production.

This submission is divided into six sections as set out below. To provide a ready reference, quotations from the White Paper and certain illustrative calculations are provided on the left side of this submission.

I Provisions specifically related to the petroleum industry

II Taxation of capital gains

III Corporations and their shareholders

IV Economic impact of the White Paper

V Effects of the White Paper on financing

VI Other proposals for changes in taxation

5.24 The government has concluded that special rules are still needed for the mineral industry, but that they should be revised substantially to ensure that really profitable projects bear a fair share of the burden of taxation. It is recognized that the exploration for and development of mines and oil and gas deposits involve more than the usual industrial risks and the scale of these risks is quite uncertain in most cases. Consequently, special arrangements are desirable to ensure that the costs of exploration and development may be charged for tax purposes as early as possible in order that taxes will only be applied when it is clear that a project will be profitable. Secondly, it is recognized that the exploration for and development of mineral deposits continue to provide special benefits to Canada and to various provinces by creating or maintaining highly productive industry in areas other than those where rapid urban and industrial growth are already occurring as a result of both private and public efforts. Just as scientific research and development are believed to warrant some special public support, the government feels that the exploration for and development of minerals still warrant some support in a form more directly related to this activity than has been the case with past depletion. It is believed that support on a less-generous scale should suffice for this purpose.

1.50 The government has decided that some special rules should still apply in determining the income derived from the mineral industries, in order to encourage exploration for and development of mineral deposits. These inducements are intended to encourage the establishment and growth of highly productive industry in areas of Canada outside those where rapid urban and industrial growth are already occurring. However, the special rules should be revised substantially to ensure that really profitable projects pay a fair share of the national revenues, as other industries do, and that the inducements offered are efficient.

5.25 The present rules concerning exploration and development costs accomplish the objective set out in the preceding paragraph: the costs of mineral exploration and development can be deducted for tax purposes early enough so that taxes will be applied only when it is clear that a project will be profitable. Under these rules, a corporation which has as its principal business either mining, the production of oil, or certain allied activities (refining and/or distributing petroleum or petroleum products, fabricating metals or operating pipelines), may deduct Canadian exploration and development costs as they are incurred. If these costs exceed the corporation's income, then it may deduct the balance of the costs in the first subsequent year in which it has enough income.

5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than 1/3 of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph *5.29* that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.

I PROPOSALS CONCERNING THE PETROLEUM INDUSTRY

General

5.24 The Government recognizes that there are special risks inherent in the mineral industries and that large amounts of capital must be committed before it is certain that a profit will be realized. It should be added that the period from the commencement of exploration to the maturity of earning a reasonable rate of return on investment is very long. For example, HBOG began to expand its exploration and development in 1947 and since that time has invested over $515 million in these activities. No dividends were paid to its shareholders until 1961 and the total dividends paid out in the ensuing eight years amounted to only $66.2 million ($3.20 per common share as compared with a current market price of about $43). The proposed
5.25 income tax provisions recognize this long delay in achieving maturity and the high risks involved by providing incentives to attract capital to the industry.

5.40 The Government also gives recognition of the need for incentives to accelerate exploration and development of mineral deposits because the
5.24 nature of such activities, "... encourage(s) the establishment and growth of highly productive industries in areas of Canada outside those where
1.50 rapid urban and industrial growth are already occurring". The regional effects on Alberta and Saskatchewan of resource development are well known and are well documented in prior briefs submitted by the Canadian Petroleum Association. Similar regional development including new roads, bridges, railroads and aviation facilities will undoubtedly occur

5.38 As mentioned earlier, the government has concluded that the tax system should continue to contain in incentive of this nature. However, it believes that the present incentive is inefficient in two respects. First, depletion applies to all production profits regardless of the exploration effort of the taxpayer. It is only indirectly related to the activity it seeks to encourage. If a taxpayer stumbles on a mine, he would, under present rules, be entitled to a depletion allowance against the profits from that mine for all time to come, even if he never spends another cent exploring for minerals.

5.41 Under the proposed system, a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Once the system is fully effective, a taxpayer's allowances would end when his profits before "eligible expenditures" exceed twice the amount of those expenditures. Consider the following example:

Profits before eligible expenditures	$6,003
Deduct eligible expenditures	3,000
	3,003
Maximum depletion $1,001 (1/3 of $3,003)	
Earned depletion (1/3 of $3,000)	1,000
Taxable income	$2,003

1.52 The second change concerns depletion allowances. The existing maximums would continue to apply—generally no more than one-third of production profits—but a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Every $3 of qualifying expenditures made after this White Paper is published would "earn" the taxpayer the right to $1 of depletion allowances if and when his production profits permit. Depletion allowances on new properties would have to be "earned depletion" immediately: "unearned" allowances would be continued for five years on existing properties as a transitional measure. This proposal is more fully explained in Chapter 5. That chapter also sets out other changes of detail applying to the mineral industry. They flow mainly from other more general changes proposed in the tax system.

5.42 The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enable the mineral industries to make a smooth transition to the new system.

as the industry moves to the offshore areas of the east and west coasts and further northward into the Northwest Territories and the Arctic Islands. Without these expenditures by the resource industries, the Federal Government would be called upon for increased transfer payments and for development costs in remote areas. In addition to direct taxation, significant contributions are made by the petroleum industry to governments at all levels by way of bonus payments for mineral rights, annual lease rentals and royalty payments. The petroleum industry has also directly influenced the establishment and growth of secondary industries which support exploration and development activities. These other industries make further tax and non-tax contributions to government and provide additional employment opportunities. Another factor of major importance to Canada is that the balance of payments is materially assisted by export sales of hydrocarbons and sulphur, and by capital investment inflows.

Production Depletion

5.38 The Government proposes to restrict the depletion incentive by
1.52 relating the amount claimable to exploration and development expenditures.
5.41 The principle of earned depletion is logical and acceptable, but we wish to point out the following inequities of the proposal:

1) The White Paper provides that the depletion incentive
5.42 on properties held on November 7, 1969 will have to be earned commencing 1976. Eligible exploration and development expenditures made between November 7, 1969 and the end of 1975 will "earn" depletion at the rate of one dollar for every three dollars spent

5.42 The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enable the mineral industries to make a smooth transition to the new system.

5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than 1/3 of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph *5.29* that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every \$3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to \$1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.

and this accumulation of earned allowances is intended
5.42 to provide "a smooth transition to the new system". This transitional period would appear to be a poor substitute for the present unrestricted depletion incentive which has been earned through the exploration and development expenditures incurred to November 7, 1969. This opinion is further supported by the fact that the investment for finding and developing the present reserves was evaluated and made on the basis of present legislation. Therefore, developed properties held on November 7, 1969 should logically be exempt from the earning provisions.

2) We accept the philosophy that depletion be granted as an incentive to encourage exploration, but the cost of mineral rights should earn depletion as their acquisition
5.40 is the first step in an exploration program. We contend that the cost of mineral rights is as much a cost of exploration as is the seismic or drilling service. Of the regions in Canada that are prospective areas to search for hydrocarbons, over 96% of the mineral rights are owned by the Crown. A more complete and effective incentive would be provided if the cost of the mineral rights would earn depletion. This fact is particularly significant because of the trend toward

EXAMPLE 1
EFFECT OF EXPLORATION AND DEVELOPMENT
EXPENDITURES ON DEPLETION ALLOWANCE

	Case 1	Case 2	Difference
Production revenue	$10,000	$10,000	-
Operating expenses and capital cost allowance	2,000	2,000	-
	$ 8,000	$ 8,000	-
Exploration and development expenditures	2,000	5,000	$3,000
Income subject to depletion	$ 6,000	$ 3,000	$(3,000)
Depletion allowance @ 33 1/3%	$ 2,000	$ 1,000	$(1,000)

The amount of depletion in Case 2 is reduced by $1,000 because of the additional $3,000 of exploration and development expenditures.

5.39 A second inefficiency is also related to the fact that the depletion allowance applies to all production profits without limit. Because exploration and development costs must be deducted in computing production profits for this purpose, the operator of a mineral resource can logically claim he is inhibited from engaging in exploration by the rules concerning depletion. The exploration costs reduce the depletion allowance: therefore it can be argued that the provision designed to increase exploration can in some cases reduce it.

exploration in the more northern areas of Canada, the Arctic Islands and offshore where the inherent risk is substantially higher than in areas the industry has explored to date.

3) Since exploration and development expenditures would continue to reduce the amount of depletion claimable, as shown in Example 1, this proposal is contrary to the basic principle in the White Paper that depletion be granted to encourage exploration. The cost of mineral rights have a two fold adverse effect on the depletion incentive. Firstly, as an exploration and development expenditure, mineral rights reduce the
5.39 amount of depletion claimable; secondly, the White Paper also proposes that mineral rights do not earn depletion. The White Paper recognized the inefficiency that exploration and development expenditures have on depletion, but no change was advanced to correct it.

In a submission in response to the Carter report, we suggested that depletion be calculated at 25% of gross income, limited to 35% of exploration and development expenditures, including the cost of mineral rights. This method would eliminate the disincentive inherent in the proposed system, retain a limitation on depletion claimed related to exploration and development, and

EXAMPLE 2
HBOG PROPOSAL FOR CALCULATING DEPLETION ON GROSS INCOME

	Year 1	Year 2	Year 3	Year 4
Taxable Income				
Production revenue	$4,500	$4,500	$5,000	$5,600
Less: well operating costs	900	900	1,000	1,200
Net production revenue	$3,600	$3,600	$4,000	$4,400
Less: Capital cost allowance	700	700	800	700
Exploration and development expenditures - mineral rights	400	500	100	600
- other	1,100	1,300	2,000	1,200
	$2,200	$2,500	$2,900	$2,500
Income before depletion	$1,400	$1,100	$1,100	$1,900
* Depletion	500	600	700	600
Taxable income	$ 900	$ 500	$ 400	$1,300

* 20% of production revenue subject to earned depletion below

	Year 1	Year 2	Year 3	Year 4
Earned Depletion				
Exploration and development expenditures - mineral rights	$ 400	$ 500	$ 100	$ 600
- other	1,100	1,300	2,000	1,200
	$1,500	$1,800	$2,100	$1,800
Earned Depletion: Current year - 1/3 of exploration and development, including mineral rights	$ 500	$ 600	$ 700	$ 600
From prior year	-	-	-	-
	$ 500	$ 600	$ 700	$ 600
Depletion claimed	500	600	700	600
Unclaimed earned depletion carried forward	$ -	$ -	$ -	$ -

5.43 Under the present legislation a depletion allowance of 25 per cent may be deducted by non-operators from their income from mineral properties. This provision applies principally to the holders of royalties. The concession sought to recognize that royalties might well in part be a return of capital. This fact would under the present proposals be more accurately recognized by the proposed rules concerning the amortization of the cost of acquiring mineral rights. Therefore it is proposed that the percentage depletion at present available to non-operators be repealed.

at the same time correct other inequities and inefficiencies. The latter are the illogical treatment of proceeds received on the sale of mineral rights which is discussed on page 10 of this submission and also the non-depletable income attributed to gas plants which is currently a controversial provision under the existing Act.

Our previous suggestion appears valid but in view of subsequent events, it is recommended that the provisions be modified slightly in order to retain a reasonable incentive which would be competitive with foreign investors. It is proposed that depletion be calculated as 20% of gross income limited to 33 1/3% of exploration and development costs, including the cost of mineral rights (Example 2). Alternatively, if mineral rights are excluded, a higher earning rate would be warranted.

Royalty Depletion

The White Paper proposes to repeal the 25% depletion allowance for
5.43 non-operators. It is not clear whether or not royalty income is to be treated as working interest income on which depletion could be claimed at 33 1/3% subject to the limitations of "earned depletion". HBOG suggests that to operators no significant distinction exists between royalty and working interest income as both are common methods of sharing production. Both types of income should have the identical incentive for exploration and development. Therefore production depletion could be claimed on royalty

1.50 The government has decided that some special rules should still apply in determining the income derived from the mineral industries, in order to encourage exploration for and development of mineral deposits. These inducements are intended to encourage the establishment and growth of highly productive industry in areas of Canada outside those where rapid urban and industrial growth are already occurring. However, the special rules should be revised substantially to ensure that really profitable projects pay a fair share of the national revenues, as other industries do, and that the inducements offered are efficient.

5.44 Also, under the present legislation a depletion alowance of 10 per cent, 15 per cent or 20 per cent may be deducted from dividends received from a mining or oil company, the percentage depending upon the proportion of the income of the corporation which is derived from production. This concession was meant to recognize that the corporation might in fact be paying dividends out of capital. Under the new system this fact would be more accurately recognized by the deduction granted to taxpayers for losses realized on shares which they have held. Therefore it is proposed that shareholders depletion be removed.

EXAMPLE 3
LOSS OF DEPLETION TO SHAREHOLDERS
(Assuming closely-held company cannot elect the partnership option)

	Closely-Held Company		Widely-Held Company	
	Resource	Industrial	Resource	Industrial
Pre-Tax Income	$600	$600	$600	$600
Depletion	200	-	200 **	-
Tax Paid	200	300	200	300
Dividend to Shareholder	400	300	400	300
Tax Credit	200	300	100	150
Taxable Amount to Shareholder	600	600	500	450
Gross Tax Payable (50%)	300	300	250	225
Tax Credit	200	300	100	150
Net Tax Paid by Shareholder	100	-	150	75
Net Proceeds to Shareholder	$300 *	$300 *	$250 **	$225**

* Entire effect of depletion is lost in a closely-held company because net proceeds to shareholders of resource and industrial companies are equal.

** The $200 depletion incentive allows the resource company to pay its shareholder a dividend that is $100 more than the industrial company's. The net after-tax proceeds to the resource company shareholder are only $25 more than those of the industrial company shareholder. The proposed integration procedure will tax away 75% ($75/$100) of the depletion benefit.

interest income subject to the earning provisions.

For those non-operators who do not participate in exploration and development, we suggest that the privilege be withdrawn over a 5 year period. Immediate withdrawal of the depletion allowance to such parties would mean some confiscation of capital as their evaluation of a royalty interest would have considered the depletion allowance.

Loss of Depletion Incentive to Shareholders

The White Paper presents some of the Government's proposals with such deceptive simplicity that the real effect is not always apparent. For example, the resource industries are currently entitled to a deduction for depletion at a rate of 33 1/3% of the profits reasonably attributable to the production of oil, gas, prime metals or industrial minerals. The
1.50 Government has concluded that the tax system should continue to provide this depletion incentive to investors in resource industries. However, it is proposed that corporate income be treated on a flow-through basis, with the shareholder grossing up his dividend and claiming credit for taxes paid by the corporation. This integration of income concept has the effect of
5.44 taking away 75% of the benefits of depletion in the case of a widely-held company and all of the depletion benefit for a closely-held corporation to whom the partnership option is unavailable. Example 3 illustrates the loss of the depletion benefit to the shareholders of resource companies by comparing the flow-through of income with a non-resource company. Since the government proposes to continue a depletion incentive, we contend that the proposals will have to be modified in order that the

5.27 Since 1962, the cost of acquiring oil rights or natural gas rights has been included in the definition of exploration and development expenses. Consequently these costs have been deductible for tax purposes within the limits of the rules relating to exploration and development expenses. It is proposed that this rule be retained, and that it be expanded to cover the costs of other mineral rights.

5.28 Also since 1962, the proceeds of sale of oil rights and natural gas rights have been treated as taxable income. As part of the proposal to tax capital gains, this rule would also be extended to apply to all mineral rights. A special rule would be applied to the proceeds of the sale of rights which are held on the day this White Paper is published if the proceeds of the sale of those rights would not have been income for tax purposes under the existing rules. This special, transitional rule is similar to that proposed in paragraph *5.8* with respect to existing goodwill; if the sale is in the first year of the new system, only 60 per cent of the proceeds would be taken into account; if in the second year, 65 per cent; the third year 70 per cent; and so on, increasing by 5 per cent each year until all of the proceeds are taken into income if the sale is in the ninth or a subsequent year. Since the cost of these rights would henceforth be deductible for tax purposes, prices should rise and this system should produce a fair after-tax return to the present owners.

5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than 1/3 of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph *5.29* that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.

EXAMPLE 4
SALE OF MINERAL RIGHTS

	COMPANY "A"		COMPANY "B"		
	Depletable Income	Non-Depletable Income	Depletable Income	Non-Depletable Income	Total
Year 1					
Income before Depletion	$9,000	$ 5,000	$12,000	$ 7,000	$33,000
Depletion	3,000	-	4,000	-	7,000
Taxable Income	6,000	5,000	8,000	7,000	26,000
Taxes (50%)	3,000	2,500	4,000	3,500	13,000
Year 2					
Assume mineral rights are sold from A to B for $6,000					
Income	$9,000	$ 5,000	$12,000	$ 7,000	$33,000
Mineral rights sold from Company A to Company B	-	6,000	(6,000)	-	-
Income before Depletion	9,000	11,000	6,000	7,000	33,000
Depletion	3,000	-	2,000	-	5,000
Taxable Income	6,000	11,000	4,000	7,000	28,000
Taxes (50%)	3,000	5,500	2,000	3,500	14,000

depletion incentive can flow through to the shareholder.

Sale of Mineral Rights

The Government has invited comments on other income tax provisions
5.27 which might be considered in tax reform. The White Paper makes no
5.28 comment on the subject of the tax treatment accorded the sale of mineral
5.40 rights. Under current legislation, the cost of mineral rights acquired by an oil company must be applied as a reduction of income subject to depletion. However, the proceeds from the sale of such rights are taxed at the full rate. Example 4 shows the results of this illogical treatment and we believe the Income Tax Act should be revised to eliminate this anomaly. The correction could be made very easily by treating the proceeds from disposals as a reduction of exploration and development expense. This inequity would be eliminated, as a matter of course, by implementing our proposal to calculate depletion on gross production income. Adequate provisions exist in the present legislation to tax at ordinary income rates those taxpayers whose principal business is that of buying or selling this type of asset.

3.1 The government proposes that capital gains be taxed. We recognize that this would be a major and controversial step, but we have concluded that the step must be taken if Canada's tax system is to be fair, and if it is to be effective.

3.3 The government rejects the proposition that every increase in economic power, no matter what its source, should be treated the same for tax purposes. This proposition, put forward forcefully by the Royal Commission on Taxation, has often been summarized rather inelegantly as "a buck is a buck is a buck." But although the government does not accept this theory in all its splendid simplicity, neither does it believe that the distinction between a so-called "capital gain" and an income receipt is either great enough or clear enough to warrant the tremendous difference between being completely exempt and being completely taxable.

3.18 As stated, all or part of the capital gain would be treated as income, depending upon the type of asset involved. The general rule would be that capital gains would be fully taxable. However, special rules would be provided to reduce the tax in the case of a taxpayers' principal residence, other property held for personal use or enjoyment, and shares of widely-held Canadian public corporations. Special rules would also reduce the tax on the sale of bonds and mortgages which are held on the day this White Paper is published. These rules, and the special rules concerning losses, are explained in the following paragraphs.

II TAXATION OF CAPITAL GAINS

3.1 HBOG agrees that greater equity in taxation will be achieved by
including capital gains in the tax base. We do not, however, believe that all
3.3 income should be taxed on the same basis; recognition should be given to the
3.18 risks involved and the contribution to the country's economic growth.

Canada is in the early stages of development and the growth of its economy is contingent upon the utilization of its huge natural resources. It is a young country with rapidly increasing needs for capital in the private sector, and our tax system should be designed to encourage capital accumulation by Canadians. Most countries which have a capital gains tax have a mature economy in which large amounts of capital have been accumulated. The proposal to tax capital gains at full rates is incompatable with Canada's goals for economic growth. A tax system should encourage Canadians to save and invest to develop the full potential of this country. Taxing capital gains at full marginal rates and taxing unrealized gains will have the reverse effect by encouraging spending in preference to saving.

Distinction Between Capital Gain and Income Receipt

There is sufficient distinction between a capital gain and an income receipt that the proposal to tax both at full marginal rates is unreasonable for the following reasons:

1) A capital gain usually has an element of risk much greater than that involved in earning an income receipt.

2) Transactions giving rise to capital gains usually involve initiative, judgment and planning elements which are basic to a free, democratic society.

2.56 The method proposed is as follows: when the income in the taxation year exceeds the average of the taxpayer's income in the preceding four years by more than one-third, the excess income would be taxed as though it were subject to a graduated rate schedule in which the income brackets to which each rate applied were five times as wide as normal. The formula is necessarily complicated but this would not concern taxpayers because it can be applied on their behalf. Tables 11 and 12 show the application of the formula in more detail.

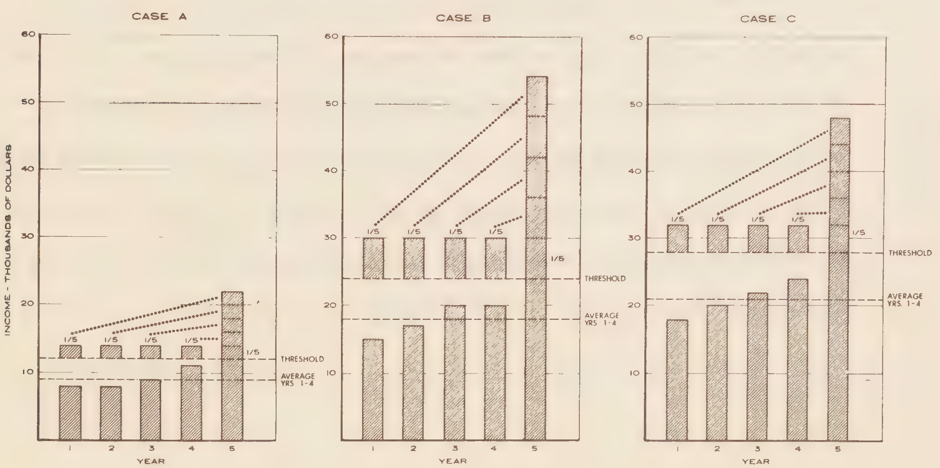
2.57 It is not proposed to remove the present averaging formula for farmers or fishermen, who would be free to use either system. But a year included in a block of years averaged under the present system could not be used in applying the proposed new formula.

Lump-sum payments out of pension funds, or from employers on retirement, could be averaged on the new formula or, subject to certain safeguards, paid into a registered retirement savings plan, over and above the normal limit on such payments.

(PART)

EXAMPLE 5
BENEFITS OF PROPOSED AVERAGING SYSTEM
(Assuming Married Taxpayer with no Dependents and large Capital Gain included in 5th year's income)

Line No.	Description	Case A	Case B	Case C
1	Average income during 4 prior years (before exemptions and deductions)	$ 9,000	$18,000	$21,000
2	Income during 5th year	22,000	54,000	48,000
3	Threshold amount (1.333 x Line 1)	12,000	24,000	28,000
4	Excess of 5th year income over threshold amount (line 2 - line 3)	10,000	30,000	20,000
5	Threshold amount plus 1/5 of excess (line 3 + 1/5 of line 4)	14,000	30,000	32,000
6	Tax on line 5 amount	3,494	10,765	11,789
7	Tax on threshold amount	2,749	7,841	9,741
8	Difference (line 6 - line 7)	745	2,924	2,048
9	Tax on excess (5 x line 8)	3,725	14,620	10,240
10	Tax on threshold amount	2,749	7,841	9,741
11	Total tax on averaged 5th year income	$ 6,474	$22,461	$19,981
12	Tax on 5th year income without averaging	$ 6,920	$22,648	$19,981
13	Saving through averaging	446	177	-
14	Excess of 5th year income over average of prior 4 years (line 2 - line 1)	13,000	36,000	27,000



3) A capital gain generally occurs over a relatively long period of time during which its realization is subject to the effects of the business cycle and inflation. Taxing such gains at full marginal rates would put an additional load on the victims of inflation.

To recognize the significant difference between ordinary income and risk income, we recommend that capital gains be taxed at substantially lower rates than other income with a maximum rate of 25%, which could be achieved by including no more than one-half of the gain in taxable income. Similarly the same proportion of any capital loss would be deductible in determining taxable income.

Averaging Provisions

2.56 The proposed averaging provisions are entirely inadequate to provide relief from the punitive effects of taxing capital gains at full marginal rates and are completely ineffectual for taxpayers with annual taxable incomes of $18,000 or more. Example 5 demonstrates the gross inadequacy of the averaging provisions.

We believe that equitable tax reform would not maintain different methods of averaging taxable income dependent on the taxpayer's occupation.

2.57 (part) For example, fishermen and farmers would be allowed to continue using their current averaging system which is much more generous than the White Paper proposal. Provisions should be the same for all taxpayers because the reasons for allowing averaging of taxable income do not differ among taxpayers.

3.37 Periodic revaluation would also reduce the "lock-in" effect that might well otherwise occur. If a taxpayer faces a tax on the sale of an investment, and that tax is postponed if he holds on to the investment, he may feel "locked in". As long as he holds, he would have, say, $100 working for him. If he sells, he would have only, say, $90 or $95 to reinvest. Since periodic revaluation would reduce this lock-in effect, it would reduce what might otherwise be an obstacle to the workings of the capital market. Revaluation would also make it feasible for the government to classify more corporate reorganizations and mergers as tax-free transactions than would otherwise be the case, thus removing a tax barrier that might otherwise have impeded transactions that are desirable for economic reasons. Finally, it would reduce the tax postponement which would otherwise result from the treatment suggested in paragraph *3.42* to those cases where the lack of marketability of the assets made the treatment compelling.

3.36 The proposal that the accrued gains or losses on those shares be taken into account every five years is one of two exceptions to the general rule that capital gains and losses would be taxable only when they are realized. (The other exception concerns taxpayers who leave Canada.) Periodic revaluation would reduce somewhat the value of the half-gains rule. It would reflect the fact that these shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily at the time of his choosing. The shares of private companies do not have the same marketability.

3.33 Taxpayers other than widely-held Canadian corporations would include only one-half of their gains on the sale of these shares in taxable income and deduct only one-half of their losses. However, they would be required to revalue these shares to market value every five years and take one-half of the resulting gain or loss into account for tax purposes in that year. A special rate is proposed for widely-held Canadian corporations to avoid double tax. This is explained in Chapter 4.

3.38 The process would not begin until five years after capital gains become taxable. Beginning in the fifth year, individual taxpayers would revalue their holdings of shares of widely-held Canadian corporations in each year in which they attain an age that is divisible by five. Corporations would also revalue their holdings of these shares every five years, likely on the fifth anniversary of incorporation and each other anniversary divisible by five. Dispersing the valuation process through a five-year cycle would reduce the pressure in any particular year—the pressure of the work load on the administration and the pressure that might otherwise develop on market prices every five years. To further disperse this latter pressure, it is proposed that revaluation take place as of the end of the month in which the significant birthday or anniversary takes place.

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Deemed Realization of Capital Gains

Although HBOG concurs with the principle of taxing capital gains, we do not agree with the principle of taxing unrealized gains. This proposal was
3.37 included to counter the lock-in effect of unrealized gains, but the possible solutions do not appear to solve this problem effectively and equitably. The
3.33 proposed five year revaluation is unduly harsh for the following reasons:

1) The proposal places undue hardship on those who would have to pay taxes because of the difficulty of financing the tax payment when the asset has not been sold.

2) The quoted market prices of corporations are not a completely rational indicator of the "worth" of a corporation. The realization of the quoted price on a large block of shares may be impossible to achieve particularly when only a small proportion of the corporation's equity is publicly held. In many instances, such a large block can only be sold at a sharp discount from the quoted price. An examination of the statistics for trading activity on the various stock exchanges in Canada will show, for many companies, the
3.36 limited marketability for small blocks of shares held by individual investors. This fact causes us to question seriously the White Paper's generalized assumptions concerning marketability of shares in many widely-held corporations.

3) It is difficult to rule out entirely the possibility of manip-
3.38 ulation or pressure on month-end prices particularly in the

case of the five-year anniversary of a holder of a large block of shares. Such coercion would not necessarily be caused by the specific holder but possibly by outsiders seeking to artificially inflate or deflate the quoted value.

4) The taxation of deemed realizations would cause major shareholders to lose control of their corporation, through forced sale of shares to pay their tax. The proposal would introduce a negative incentive on "going public", even though this procedure might have been the only method of raising the funds necessary for the growth of the company.

5) Severe fluctuations in market prices could create an artificial paper gain on the taxpayer's fifth anniversary that could be completely eliminated before the payment of tax on the deemed realization is due. If he does not sell his shares, he must wait another five years before claiming the loss.

6) The proposal would create much additional record keeping for both the taxpayer and the Government.

7) The proposal places at a disadvantage those foreign investors who were encouraged in the past by Federal Government incentives to offer a common equity interest to Canadian investors.

For these reasons, HBOG recommends that the proposal to tax deemed

3.40 The other deemed realization would occur when a taxpayer gives up Canadian residence. The general rule would be that he would be treated as if he had sold all his assets on that day at their fair market value. On the other hand, when a taxpayer moves to Canada he would generally be treated as though he had on that day purchased his assets at their fair market value. The combination of these two rules would mean that Canada would tax only the increase in value that arises during the time that the owner is resident in Canada.

Principal Residences

3.19 Generally, capital gains on the sale of homes would not be taxed. This would be accomplished by providing that when a taxpayer sells his principal residence only the profit in excess of $1,000 per year of occupancy would be taxed, and by granting the "rollover" discussed in the next paragraph. Both of these provisions would of course apply on the sale of a farm with farmhouse that has been a principal residence. The $1,000 per year exemption would also compensate for the fact that losses on the sale of a taxpayer's residence other than a farmhouse sold with the farm, would not be deductible from income for tax purposes. The government believes it would be virtually impossible to distinguish between losses which arise from changes in the real estate market and losses which arise from the aging of the house and normal wear and tear. Naturally in calculating his profit the taxpayer would be able to take into account the cost of the improvements he has made. If he does not bother to keep records, he would be allowed instead a home improvement allowance of $150 per year of occupancy.

realizations of capital gains on widely-held corporations should be eliminated.

We sympathize with the Government's intention to tax capital leaving
3.40 Canada, including taxing of unrealized gains for those who leave permanently. However, we believe that provision should be made for the protection of persons leaving Canada on a temporary basis for the purpose of obtaining training or experience.

Principal Residences

Home ownership is a part of the Canadian way of life and has been encouraged by various public and private programs. Generally most increases in house values represent gains due almost entirely to inflation. The suggested $1,150 exemption ($1,000 + $150) would have been inadequate
3.19 even for average homes in most locales during the 1965 - 1970 period. We agree with the Government it is difficult to distinguish between losses arising from changes in the real estate markets and from aging and normal wear and tear. To tax gains but disallow any losses does not appear equitable. We understand that the expected revenue from this source is not large and therefore question the efficiency of this proposal in view of the national effort necessary by both the public and Government to enforce this measure. The record keeping necessary to enforce this provision would be another irritant to the average taxpayer. HBOG feels that the purchase of a home is the largest single investment the average taxpayer makes and he should not be required to pay tax on inflated values which do not increase his wealth. Accordingly we propose that any "capital gain" made on a taxpayer's principal residence be exempt completely from taxation.

4.19 The government's proposal is to create one set of rules for the closely-held corporation—the incorporated proprietorship or partnership—and another set of rules for the widely-held, public corporation. This distinction reflects the difference in the relationship between the two types of corporations and their respective shareholders. It also reflects the fact that, by and large, the closely-held corporation competes with proprietorships, partnerships and of course with other closely-held corporations, while the public corporation competes with other public corporations, both Canadian and foreign.

1.40 For closely-held corporations, which are usually smaller businesses managed by the shareholders, the tax should be related as closely as possible to rates paid by individual shareholders. There is usually a close identity between the shareholders and the corporation. These corporations usually compete in markets with unincorporated businesses subject only to personal income tax. Under the proposed plan the federal income tax paid by such corporations would be treated as a prepayment of the personal income tax on behalf of individual resident shareholders. Under certain conditions the corporation could elect to be taxed as a partnership of its shareholders. In other cases the shareholders would pay tax on a sum that includes their dividends plus a related amount of corporate tax already paid; and they would then claim credit for the corporate tax paid, and qualify for a refund if their own rates are lower than the corporate rate.

4.2 The relationship between corporation and shareholder also differs substantially from corporation to corporation. A shareholder who owns a substantial proportion of the corporation's shares will usually take an active part in its affairs. Indeed, he will often work full-time or part-time for it. His asset is a share certificate representing claims on the corporation; for example, the right to receive the same dividend per share as others who own the same type of share, or to receive the same amount per share as those others if the corporation is wound up. However, in his mind he is part owner of all of the corporation's assets and operations.

4.24 In the case of those corporations which are not to be treated as partnerships, parity with the shareholders of partnership corporations would be achieved in two steps. There would be a tax of 50 per cent on the taxable income of the corporation. However, when the net profits are distributed to the shareholders, credit would be given for the full amount of the tax paid by the corporation on those profits.

4.33 Meanwhile gains realized on the sale of shares in closely-held corporations would be taxed as ordinary income, and losses suffered on the sale of such shares would be deductible from other income for tax purposes. When coupled with the system of full integration, this would mean that the tax effects would be the same whether an individual causes his corporation to sell its assets to a prospective purchaser or chooses to sell his shares to that purchaser, thereby giving the purchaser indirect control of the assets.

1.42 Widely-held corporations are usually larger businesses where the link between shareholders and management is tenuous. Such corporations are themselves important economic entities. Their products or services are usually sold in competition with other large corporations, where prices yield an adequate return after paying corporate tax. One half the corporate income tax paid by such corporations would be regarded as a prepayment of individual tax for individual Canadian resident shareholders, but the other half would not be linked in this way. Shareholders receiving dividends from profits taxed under the new plan would be liable for tax on the dividend plus an amount of "creditable tax" equal to half the dividend and would be given credit for that amount of tax. This system would be roughly equivalent to the present dividend tax credit for taxpayers in the 50-per-cent tax bracket and would be more favorable for those in lower tax brackets. It would thus provide a powerful incentive for investment by Canadians in Canadian corporations.

4.34 By and large, a Canadian widely-held public corporation competes with other public corporations. In this league it is natural for the competition to bear a corporation income tax and we consider it likely that some level of corporation tax is passed on to customers in the price which the corporations charge for their goods and services.

4.36 However, the government does want to reform the dividend tax credit. It proposes to replace the existing credit with a system giving Canadian shareholders credit for one-half the Canadian corporation tax paid by the corporation on the profits from which the dividend is paid.

4.42 As mentioned above and in Chapter 3, the government proposes that half of the gain on the disposal of a share of a Canadian public corporation be taken into account in computing taxable income. This lower rate of tax on the gain would complement the partial credit given for corporate tax and provide the other half of the government's incentive to Canadians to invest in Canadian corporations. To forestall a fairly straightforward tax-avoidance technique, it would be necessary to grant deduction for only half of the loss on the sale of such a share.

III CORPORATIONS AND THEIR SHAREHOLDERS

The proposals to integrate personal and corporate taxation cause us much concern, despite our agreement, at least in principle, with their inherent objectives and equity. We foresee many unfavourable outcomes and administrative problems which will result from the proposed system in which credits are made in such a precise manner. In addition to the negative effects on financing discussed in Section V, the following comments outline our main points of concern or disagreement with the proposed integration procedures:

Distinction Between Widely and Closely-Held Corporations

The White Paper's definitions of widely and closely-held corporations are based on broad generalizations which do not fit many Canadian companies. For example, there are many large private companies who have a small
4.19 number of shareholders and who compete vigorously with publicly-owned
1.40 companies. Conversely many widely-held corporations are closely identified
4.2 with and controlled by one person or a small group of persons. It would be
1.42 most difficult to classify corporations in accordance with the rules given in
4.34 the White Paper. Size of operation is certainly a factor as important as a
4.36 stock exchange listing.

It is our opinion that the distinction between widely and closely-held corporations is at best, artificial, and will not achieve the desired results of perfect integration. In addition, we can see no theoretical reason for
4.24 taxing the capital gain from the sale of shares at different effective rates
4.33
4.42 determined only by a most imprecise definition. HBOG therefore

recommends that all corporations and their shareholders be taxed in a similar equitable manner with respect to dividends received and profits made on the sale of shares.

Proposals to Credit Corporate Tax to Shareholders

In theory, the proposals to credit shareholders with the income taxes actually paid in Canada appear to be quite reasonable and equitable. Tax allocation can be done precisely with little difficulty when an easily identifiable small group of shareholders owns a corporation whose taxes amount to about half of its pre-tax earnings. Because it is impractical and may produce undesirable results we oppose the integration system for the following reasons:

1) The proposals, in fact, favour the mature corporations that pay a high proportion of their reported earnings as income taxes and prejudice the "low-tax-paying" growth companies. These latter companies are often in the utility or extractive industries with expanding capital intensive activities whose growth should be encouraged, not stifled. Shareholders would not receive most of the tax incentives for resource industries or the benefits of tax deferral arising from liberal capital cost allowances granted to all industry.

2) "Low-tax-paying" corporations will be less attractive to the Canadian investor and therefore attract more interest from non-resident investors. In particular, foreign ownership of utilities and natural resource

4.49 The government does not propose to give foreign shareholders of Canadian corporations credit for the tax paid by those corporations. The principal reason for this decision is that the credit to Canadians in respect of corporations that compete in the international area would be given as an incentive to induce Canadians to purchase shares in these corporations. While the government welcomes foreign investment in Canadian corporations, it does not believe it is necessary to subsidize non-residents through the tax system in order to induce them to invest their capital in Canada. Canadian resources, labor and management can compete on even terms for capital with their counterparts in other countries. Because the general tax rule in other countries does not include a credit to the shareholder in respect of taxes paid by the corporation, it is not necessary for Canada to enact such a provision, and it would be quite expensive to do so; an expense that would have to be borne by the Canadian taxpayers.

4.37 Again, an example may help to explain how the system would work. A Canadian public corporation with profits of $1,000,000 would pay a tax of $500,000, leaving $500,000 available for distribution to the shareholders. If it pays the $500,000 out in dividends, it would instruct the shareholders to report $750,000 as their income for tax purposes and to claim credit for $250,000 of the $500,000 of corporate tax paid by the corporation. A shareholder who receives a dividend of $100 would therefore report $150 as the income from the corporation and would show on his return that $50 tax had been paid by the corporation, $40 federal and $10 provincial. If his marginal tax rate is 40 per cent, the tax on the dividend would be $60 and he would owe the governments $10. If his marginal tax rate is less than one-third he would be entitled to a refund. As in the case of closely-held corporations, this procedure would be applied both to cash dividends and to stock dividends so that the process should not by itself force corporations to pay out in cash a higher porportion of their profits than they would under the present system. Also, as in the case of closely-held corporations, the credit would only be given if the corporation declares these dividends within the time limits prescribed.

based companies would be increased.

3) HBOG agrees that only Canadian taxpayers should receive the benefits of any credit for corporate
4.49 taxes and that such credit should be of no particular advantage to others. We foresee the possibility of artificial manoeuvres designed to credit the maximum corporate tax to Canadian shareholders.

4) The proposals are relatively complicated and will involve much additional record keeping by the Government and by both corporate and individual taxpayers. We view the proposed crediting procedure as inefficient and costly from a Government administrative point of view. For example,
4.37 many new "taxpayers" will be added to the tax rolls in order to receive a refund of their tax credit. In many cases the administrative cost to the Canadian Government and hence to the Canadian public will exceed the amount of the refund.

5) We are also concerned about the many problems surrounding the assessment of corporate tax returns and the actual crediting procedure through to the shareholder. At present a substantial time

EXAMPLE 6

REQUIRED TAX PAYMENT BY SHAREHOLDER OF WIDELY-HELD CORPORATION WHO RECEIVES A STOCK DIVIDEND

	Margin rate of Taxpayer					
	0%	20%	30%	33 1/3%	40%	50%
Pre-tax income	$ 200	$ 200	$ 200	$ 200	$ 200	$ 200
Corporate tax	100	100	100	100	100	100
Available for distribution as stock dividend	$ 100	$ 100	$ 100	$ 100	$ 100	$ 100
Creditable tax	50	50	50	50	50	50
Personal taxable income	$ 150	$ 150	$ 150	$ 150	$ 150	$ 150
Personal tax	-	30	45	50	60	75
Tax payable or (refund)	$ (50)	$ (20)	$ (5)	-	$ 10	$ 25

4.26 This procedure of giving credit to the shareholder for taxes paid by the corporation would be applied both to cash dividends and to stock dividends, so that the process should not by itself force private corporations to pay out in cash a higher proportion of their profits than they would under the present system. In the case of a stock dividend, the shareholder would of course not have received any cash from the corporation with which to pay his tax. However, the credit he receives for the tax paid by the corporation would cover his liability on the dividend unless his marginal tax rate exceeds 50 per cent. Therefore the system would not result in taxpayers being forced to pay tax at a time when they lack means to satisfy the tax liability.

EXAMPLE 7

TAXES PAID ON A STOCK DIVIDEND FROM A WIDELY-HELD CORPORATION REPRESENT A PRE-PAYMENT OF CAPITAL GAINS TAX
(Assuming 50% marginal tax rate)

		Cost Basis of Investment	Payments (Receipts)
January 1, 1971	Purchase of shares	$10,000	$10,000
July 1, 1971	Receive stock dividend of $300	300	-
April 30, 1972	Payment of income tax related to stock dividend	10,300	75*
May 15, 1972	Proceeds from sale of shares		(11,000)
April 30, 1973	Payment of income tax related to capital gain		175**

*Tax Calculated as Follows:

Stock dividend	$300
Creditable tax	150
Tax income to shareholder	$450
Tax at 50%	225
Less: Creditable tax	150
Tax payment	$ 75

**Tax Calculated as Follows:

Proceeds from sale	$11,000
Adjusted cost basis	10,300
Adjusted capital gain	$ 700
Taxable portion	350
Tax at 50%	175

Tax Calculation with no Stock Dividend

Proceeds from sale	$11,000
Original cost	10,000
Capital gain	$ 1,000
Taxable portion	500
Tax at 50%	250

Total Taxes Paid = $75 + $175 = $250

lag occurs between issue of a T-5 form showing dividend income paid to shareholders, and the completion and assessment of the corporation's income tax return. Large amounts of tax are often in dispute between the taxpayer and the Government; any procedure to properly credit taxes once the issues are settled appears cumbersome at best. This whole procedure will involve great time delays if the example of crediting income taxes to utility consumers is typical.

6) It is proposed that private corporations, to conserve cash, could pass on creditable tax to its shareholders by declaring stock dividends. Its shareholders would not receive any increase in value nor pay any additional
4.26 tax. A stock dividend from a widely-held company would require the shareholder to pay additional tax if his marginal tax rate exceeds 33 1/3% (Example 6). The value of his holdings would be unchanged and the additional tax would be merely a prepayment of capital gains tax (Example 7). There is no practical procedure for withholding tax on stock dividends declared to non-residents and none is proposed in the White Paper.

Suggested Revision

It is recognized that a problem exists with respect to the ultimate taxation of corporate income in the hands of a shareholder. Despite the

EXAMPLE 8
MODIFICATION OF PRESENT DIVIDEND TAX CREDIT SYSTEM
TO GIVE SAME EFFECT AS WHITE PAPER PROPOSAL TO
SHAREHOLDER OF A WIDELY-HELD CORPORATION

	Marginal Rate of Taxpayer			
	20%	30%	40%	50%
White Paper Proposal				
Dividend received	$ 100	$ 100	$ 100	$ 100
Plus taxable credit	50	50	50	50
Taxable amount	$ 150	$ 150	$ 150	$ 150
Gross tax	$ 30	$ 45	$ 60	$ 75
Less credit	50	50	50	50
Tax payable (refund)	$ (20)	$ (5)	$ 10	$ 25
Present Dividend Tax Credit Modified				
Dividend received	$ 100	$ 100	$ 100	$ 100
Gross tax at marginal rate	$ 20	$ 30	$ 40	$ 50
* Less tax credit	(40)	(35)	(30)	(25)
Tax payable or (refund)	$ (20)	$ (5)	$ 10	$ 25
* Dividend tax credit rate	40%	35%	30%	25%

equity and theoretical attractiveness of the White Paper's integration proposals, for practical purposes dividend income from all corporations should be treated in a similar fashion irrespective of the corporate taxes actually paid. The present 20% dividend tax credit has had substantial acceptance among Canadian taxpayers. We believe that little, if any, change is necessary with the present system and that most of the desired results of the integration proposals could be achieved by relatively minor changes in the existing 20% rate. If thought necessary, incentives to invest in Canadian equity securities could be given to taxpayers at the lower end of the income scale. Such an incentive could take the form of a higher tax credit than that available to high income persons. Tax credit rates could be scaled, as illustrated in Example 8, to produce results similar to the integration proposals. In making modifications to the existing dividend tax credit system, refunds of creditable amounts would not be made to persons having no taxable income. Alternatively refunds should not be made for amounts less than (say) $25.00 in order to minimize the administrative cost of making such refunds.

IV ECONOMIC IMPACT OF THE WHITE PAPER

It is impossible to predict all of the consequences of the revolutionary tax reforms which the White Paper proposes, but they will undoubtedly have far-reaching effects on the Canadian economy. A prime concern is for the inflationary potential inherent in the proposal to transfer large sums of money from the middle and high income groups to the Government and the low income group. This transfer from people who generally save and invest money to sectors of the economy with a high propensity to consume must inevitably be inflationary since those funds will create more demand rather than more production facilities. As the resulting erosion of the value of the dollar is compensated for by rising wage rates, many of those who were relieved of tax burdens would gradually reassume them.

The expectation of carrying a higher tax burden may discourage the traditional savers from accumulating their wealth at a time when Canada's need for capital formation to create jobs and for smooth functioning of the capital markets is becoming increasingly vital. A reduction of savings would not only put upward pressure on interest rates, but would also force an increased reliance on foreign investment. The foreign investor would be able to invest in equities equally as well as debt securities and the trend of foreign ownership would be accentuated.

Some impact on future capital formation will also be felt through the loss by small companies of the current tax benefit on earnings to $35,000 unless they receive a compensating accelerated write-off of capital costs. It is important that small businesses in the manufacturing and service industries be assisted in generating the capital required for growth if they

1.7 In raising the large revenues required to meet the needs of modern government, we must be certain that the total tax burden is distributed fairly. All levels of government together now require more than one-third of the gross national product in taxes, social security contributions and other revenue to provide public services. The federal government is holding its own operating expenditures under control but its total needs are growing to meet such priorities as old age pensions, hospital and medical care, support of higher education, retraining our work force, equalization payments to the less wealthy provinces, and programs for industrial and other economic development.

are to be competitive with larger corporations and with imported goods and services.

The inflationary potential of the present tax proposals also gives concern for Canada's future posture in international markets. The rapid expansion in Canada's penetration of export markets since World War II has been a major factor in Canada's economic growth. Our future ability to compete in those markets is a critical factor in the continued expansion of the Canadian economy, both in terms of selling our manufactured goods abroad and maintaining an internal price structure which will allow Canadian products to compete on favourable terms with imported goods.

The probability of further increases in the Government's share of the Gross National Product also presents considerable concern. In 1959, the three levels of Government had combined revenues exclusive of transfer payments equal to 28.2% of GNP and this share had increased to 35.9% by
1.7 1968. The GNP grew at an average rate of 7.5% annually from 1959 through 1968 whereas growth in total Government revenues ran well ahead at 10.5% per year. Using the period from 1959 to 1968 as a base and projecting that rate of increase in the Government's share of the GNP, it might be anticipated that the total revenues of the three levels of Government would exceed 43% of the GNP by 1975, a proportion approaching wartime levels.

It is well known that the junior governments have increased their requirements much more rapidly than has the Federal Government. However, if Ottawa elects to substantially increase its revenues, it is almost certain that the junior governments will follow. The trend toward more and more of Canada's annual production being taken in the form of taxes and other

2.42 The government has concluded that as the taxation of capital gains becomes fully effective, and transitional measures in the new system have ceased to be important, top rates of combined federal and provincial personal income tax should be reduced to 50 per cent. The top rates should gradually be reduced from the present levels, in four instalments commencing in the second year in which the new system applies.

Government revenues should be arrested rather than encouraged. True equity requires that corporate income be taxed at exactly equal rates in
2.42 all provinces of Canada and that the maximum personal tax rate be no higher than the respective corporate rate. The top tax level of 50% appears to be attractive but provincial requirements are almost certain to necessitate increases in this imaginary maximum rate.

HBOG agrees with the Government that changes in the tax system to block loopholes and to provide a fair distribution of the tax burden are desirable goals. We also share the Government's concern with the financial hardship of many Canadians on the lower end of the income scale. However, we feel that the proposals of the White Paper are so wide-ranging and complex that to implement them in toto would result in a serious disruption of the Canadian economy.

V EFFECTS OF THE WHITE PAPER ON FINANCING

Canada continues to require substantial capital for further development of its economy which will expand its production and employment base. Although Canadians have one of the world's highest savings rates, proportionate to income, about one-third of Canada's annual capital needs is now derived from foreign investors. Because of the inflationary effects discussed in Section IV and because substantial amounts will be taxed away from Canadian savers and investors, raising capital in Canada will become more and more difficult under the White Paper proposals. The resultant shortage of Canadian investment capital will mean that a higher proportion of our capital needs will come from external sources and that more control of Canadian industry will be subject to foreign determination. We think that the Proposals for Tax Reform will not encourage Canadian ownership of its industries. Our reasons for concluding that financing Canadian enterprise would be more difficult are as follows:

1) Higher taxation of the segment of the population who are traditionally savers and investors will reduce the available pool of Canadian capital. Taxation of capital gains at full marginal rates will also have a negative effect on capital accumulation.

2) The rate of real growth in the Canadian economy is likely to diminish under the White Paper proposals, thus reducing the rate of increase in capital generation.

3) Canadian shareholders will want increased cash dividend payouts to obtain their creditable tax and thus cause companies to have greater needs for external financing. Not all the additional dividends paid in response to the White Paper proposals will return to the investment stream. As a result, companies will require financing more frequently and the cost of capital will be higher.

4) The new foreign capital that will continue to be needed in Canada is extremely fluid and therefore quite sensitive to the recipient country's environment. HBOG is concerned that the international community will not maintain its favourable view of the economic and social climate in Canada.

5) The radical White Paper proposals will cause uncertainty as to return on investment and disrupt the generally accepted investment concepts and patterns.

6) There are no proposals in the White Paper to provide incentive for investors to buy bonds or other debt instruments. A consideration of the potential inflationary pressures portends continued high interest rates, therefore making debt financing more undesirable. Lower interest rates provide the Government with a two-fold benefit - smaller Government interest costs and

increased corporate taxable income.

The oil industry requires large amounts of capital particularly for the exploration and development of remote areas such as offshore, the Northwest Territories and the Arctic Islands. We expect that heavy capital commitments will be required to explore and develop our substantial blocks of such acreage in the coming years.

In the past HBOG has endeavoured to expand its Canadian equity ownership and will continue its efforts to do so in the future. We are concerned that the Canadian capital market will not be receptive to purchasing equity securities in a resource based company. The combination of inflation, high interest rates and a bias against the high risk petroleum industry would create very real financing problems even for a strong, emerging company such as HBOG.

8.38 A second issue is to what extent Canadian income taxes affect the ability of Canada to retain able and highly trained Canadians who could emigrate to the U.S., and to attract skilled and able persons from the U.S. or elsewhere. When the royal commission considered this matter it concluded: "We are skeptical that tax factors have been a major factor in emigration." Since then changes in conditions in the U.S. seem to have made that country less attractive to Canadians considering emigration and changes in its immigration laws have made it more difficult for Canadians to emigrate to the U.S.

VI OTHER PROPOSALS FOR CHANGES IN TAXATION

It is difficult to assess the importance of many of the other propositions offered for consideration because of the lack of definitive detail in the White Paper. However, HBOG, its employees or its shareholders will be affected by every proposed change and most of the changes would have an adverse effect on one or the other of their diverse interests. As a result, we cannot list our comments on other proposals of the White Paper in order of importance, but offer them for your consideration.

1) We agree in principle with the concept of "ability to pay" except that the White Paper proposals do not encourage, and in fact discourage, initiative, enterprise and willingness to assume the element of risk involved in the building up of business entities. The petroleum industry is dependent on those who are willing to take a chance, and on the availability of personnel who have a high degree of technical skill. If the proposals in the White Paper are implemented, both the "take a chance" investor and the highly qualified employee will find that other countries are more attractive areas in which to capitalize on their talents. The petroleum industry has difficulties in
8.38 attracting sufficient numbers of trained, skilled personnel and the proposals would aggravate this serious situation. We do not accept the statements in the White Paper which minimize the potential effects on immigration and emigration of skilled and able persons.

2.42 The government has concluded that as the taxation of capital gains becomes fully effective, and transitional measures in the new system have ceased to be important, top rates of combined federal and provincial personal income tax should be reduced to 50 per cent. The top rates should gradually be reduced from the present levels, in four instalments commencing in the second year in which the new system applies.

2.44 Taking into account the changes in rates made necessary by the increase in the exemptions, the incorporation of the old age security tax and other separate taxes and the gradual changes arising through the adjustment of the top rates, Tables 1 and 2 show the existing schedule of rates and the proposed new schedule. The top federal rate after the transitional period would be 40 per cent, and the combined federal and provincial rates would be 51.2 per cent in provinces that impose tax at the rate of 28 per cent and correspondingly greater in provinces that impose higher rates.

(PART)

EXAMPLE 9

EFFECT OF DIFFERENT CORPORATE AND PERSONAL TAX RATES

(Assuming a widely-held Alberta company taxed at a 51% rate and an Alberta shareholder taxed at a 51.2% rate)

Corporate Taxable Income	$100.00
Corporate Tax at 51%	51.00
Available for Dividends	$ 49.00
Creditable Tax	24.50
Personal Taxable Income	$ 73.50
Personal Tax at 51.2%	37.63
Less: Creditable Tax	24.50
Additional Personal Tax	$ 13.13

Comments:

1) Company pays $51 in tax but the amount of creditable tax that can be used is 50% of $49, not 50% of $51.

2) The taxpayer pays tax at 51.2% but he receives only 50% of the creditable tax as noted in (1).

5.4 There is a class of expenditure incurred by businesses that is not deductible, either in the year in which the expenditure is incurred or over a series of years. The taxpayer is prohibited from deducting them in the year in which they are incurred because they are capital expenditures. He is prohibited from deducting the cost over a number of years by way of depreciation because they do not give rise to an asset for which provision is made in the depreciation regulations. Perhaps the best known of these capital nothings is goodwill. If a Canadian buys a business, he can neither deduct nor depreciate the portion of his purchase price that relates to the goodwill of the business.

5.5 The government proposes to create a new depreciation class which would sweep up all of these nothings and which would enable the taxpayer to deduct 10 per cent of the book value of this class each year. We believe that the 10-per-cent rate is fair if one takes into account the type of expenditure to be included.

2) The White Paper, again deceptively, predicates all its theories on a 50% income tax. According to their assumptions the authors have theorized a basic personal maximum rate of 51.2%, after

2.42 taking into account provincial income tax, but no provision has

2.44 (part) been made for future increases in taxes or even the fact that most provinces already exceed the assumed rate. The White Paper suggests that all existing complex taxes and surtaxes will be supplanted by a simple tax rate with a 50% maximum. There is no constitutional guarantee that the combined Federal-Provincial rates would be limited to 50% and no assurance that the total income tax rate will be held to even the 51.2% rate quoted. Even if the 51.2% rate was held, the shareholder cannot benefit fully from the total amount of income taxes paid (Example 9).

3) The White Paper proposals include a provision which would

5.4 allow a tax deduction of expenditures for "nothings". However,

5.5 with the exception of goodwill, no details are offered. The Canadian taxpayer is left to speculate on what was to be included in this category. HBOG would suggest that a deduction should be allowed for at least the following costs of doing business:

a) Payments for rights-of-way for pipe lines

A description of the nature of pipe line rights-of-way is summarized in Exhibit II indicating the various means of acquiring and the provisions for surrendering and terminating such rights. An expenditure for a right-of-way is incurred

3.28 This category would involve investments such as bonds, mortgages, agreements for sale, and rental real estate. It is proposed that profits from the sale of these assets be brought fully into taxable income and that losses on the sale of assets of this type be fully deductible in computing taxable income. Taxpayers who obtain bonds, mortgages and agreements for sale at a discount with a low coupon yield would be in the same position as taxpayers who buy at par with a higher coupon yield.

to earn income over the operating life time of the pipe line, which is quite varied and can range over a wide number of years. Instead of including these expenditures in "nothings", we would suggest that rights-of-way for pipe lines, which serve producing wells or gather hydrocarbons for shipment through Canada's main transmission lines, be included in the same capital cost class as the pipe line; main transmission lines should also receive some recognition of the costs of rights-of-way but at a considerably reduced rate.

b) Commissions and other non-deductible costs pertaining to share and debt issues

We have listed these types of costs for inclusion in the proposed tax class for "nothings" because the White Paper suggests that the types of expenditures to be included in this new class are those presently disallowed. It is our opinion that such costs should be allowed as a deduction in the same manner that other costs of financing are presently deductible.

c) Bond discount

Bond discount should be deductible since the White Paper provides that the bond holder will be taxable on the discount.

d) Trademarks and corporate symbols

The cost of trademarks and corporate symbols are a part of a corporation's advertising and therefore should be deductible.

5.27 Since 1962, the cost of acquiring oil rights or natural gas rights has been included in the definition of exploration and development expenses. Consequently these costs have been deductible for tax purposes within the limits of the rules relating to exploration and development expenses. It is proposed that this rule be retained, and that it be expanded to cover the costs of other mineral rights.

5.28 Also since 1962, the proceeds of sale of oil rights and natural gas rights have been treated as taxable income. As part of the proposal to tax capital gains, this rule would also be extended to apply to all mineral rights. A special rule would be applied to the proceeds of the sale of rights which are held on the day this White Paper is published if the proceeds of the sale of those rights would not have been income for tax purposes under the existing rules. This special, transitional rule is similar to that proposed in paragraph *5.8* with respect to existing goodwill; if the sale is in the first year of the new system, only 60 per cent of the proceeds would be taken into account; if in the second year, 65 per cent; the third year 70 per cent; and so on, increasing by 5 per cent each year until all of the proceeds are taken into income if the sale is in the ninth or a subsequent year. Since the cost of these rights would henceforth be deductible for tax purposes, prices should rise and this system should produce a fair after-tax return to the present owners.

e) Mineral rights acquired prior to April 11, 1962

5.27 The cost of mineral rights acquired before April 11, 1962 are not currently deductible unless:

1) The mineral rights were acquired from the Crown.
2) All rights in the parcel are surrendered to the Crown.
3) No well on the parcel has had reasonable commercial production.
4) No consideration was received from any other transactions involving the mineral rights.

These restrictions have severely limited the amount of deductions for such mineral rights. It would appear that these mineral rights have been considered as "nothings" in the past and therefore, should be included in the proposed class for such assets. An allowance for these mineral rights is justified because the arbitrary distinction between mineral rights acquired before
5.28 and after the above date is illogical. Such an allowance would also tend to compensate, in part, for an inconsistency in legislation since 1962 when proceeds received on the disposition of such rights became taxable, even though the original cost was not deductible.

f) Line-fill in pipe lines

We are of the opinion that line-fill in a pipe line has been inappropriately classed as a permanent inventory. To the taxpayer, the investment in line-fill is no different than the outlay made for the pipe in the ground except that normally the former

2.11 The government has considered this issue at length. It proposes two sets of measures to remedy the disparity. First, in regard to those in business and the professions, and to certain types of benefits granted by employers to senior employees, it intends to set more rigorous limits to check "expense account living." The costs of attending conventions and belonging to clubs would no longer be permitted as a charge in determining business income. The costs of yachts, hunting and fishing lodges or camps, amounts spent for tickets for games and performances, and costs of entertainment would also be excluded. Owners or employees of a business having a car or aircraft available to them for their personal use, including travel to and from home, would have to pay the business a minimum stand-by charge, or have a corresponding amount added to their personal income for tax purposes.

5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.

will ultimately be recovered. Both items are an integral part of the investment required to generate income from pipe line operations. Accordingly, line-fill logically forms part of the pipe line investment on which capital cost allowance should be claimed at a rate of 6% on a declining balance (Class 2). The proceeds received from any line-fill recovered when a pipe line is abandoned would reduce the undepreciated capital cost in the same manner that pipe would when it is salvaged. Again, this item has been included in the particular tax class proposed for "nothings" because of the "presently disallowed concept" established in the White Paper for this proposed class of assets. We believe that it is more appropriate to include line-fill in Class 2.

2.11
5.9
5) We contend that reasonable expenses for entertainment, costs of conferences or conventions and dues for certain clubs are legitimate business costs. In any event, there is adequate provision in the existing Income Tax Act to control any of these expenses.

CONCLUSION

In this submission, HBOG has expressed its opinion on the various proposals for tax reform and offered its recommendations, which are summarized below:

General Observations:

1) Implementation of the proposals would encourage consumption which would be inflationary and detrimental to the accumulation of capital necessary for Canada's economic growth.

2) The risks of the petroleum industry and its regional development of areas in Canada are recognized in the White Paper, but no consideration was indicated of the substantial contributions made, in addition to direct taxation, to governments at all levels. The petroleum industry has also assisted in materially by improving Canada's balance of payments position.

3) A depletion allowance is proposed with certain restrictions but the benefits would be largely nullified in the flow-through to shareholders. The existing provisions have not been sufficiently attractive to encourage many Canadians to invest in the petroleum industry because the incentives have not been adequate to produce a satisfactory rate of return to the industry. The new proposals will further reduce that rate of return.

4) Greater equity will be achieved if capital gains are taxed. However taxation of such gains at full marginal rates is not equitable and is not compatible with Canada's goal for economic growth. The

proposed averaging provisions are inadequate and taxation of unrealized gains is impractical and inequitable.

5) The integration proposal appears to provide a simple solution to taxing of corporate income in the hands of shareholders. However, it would eliminate, or severely reduce, incentive allowances and would discourage economic growth as integration of personal and corporate taxation will prejudice "low-tax-paying" companies and will have negative effects on financing.

Recommendations:

HBOG recommends modification of the White Paper proposals and of existing tax law as follows:

1) A more objective approach to taxation by placing less emphasis on tax revenues and social reform; limitation of Government spending to fit reasonable revenue expectations should be an objective rather than to tailor a tax system to meet spiralling expenditures.

2) Depletion should be calculated at 20% of gross production income limited to 33 1/3% of exploration and development expenditures, including the cost of mineral rights. Developed properties held on November 7, 1969 should logically be exempt from the earning provisions.

3) Tax capital gains at lower rates than ordinary income, with a maximum rate of 25%.

4) Modification of the present tax credit system to accomplish the same results as the integration proposals.

5) Any substantial tax reforms should provide for gradual implementation to avoid serious disruption of the Canadian economy.

6) Elimination of many of the minor proposals which would produce small amounts of revenue but which would require substantial administrative costs to the Government and unrealistic record keeping by the taxpayer.

EXHIBIT I

SUMMARY OF HBOG'S OPERATIONS

Hudson's Bay Oil and Gas Company Limited was incorporated in 1926 by Continental Oil Company of the United States and The Hudson's Bay Company of England. These investors came to Canada to explore for oil and gas, but large scale exploration and development efforts were not undertaken until after 1947, when Leduc was discovered. After eight successful years, during which the Company discovered substantial reserves of crude oil and natural gas, bonds were issued to the public in 1955 to finance development of those reserves. By 1957, the Company had become a substantial producer and issued shares to the public. Further shares were issued in 1963 to acquire two exploration and producing subsidiaries. The Company continued the practice of widening its public ownership and in 1967 sold to the Canadian public preferred shares convertible into 720,000 common shares. At December 31, 1969, ownership of the Company was 65.7% by Continental, 21.9% by Hudson's Bay and 12.4% by the public.

From the foregoing, it may be noted that HBOG, a highly successful exploration and producing company, has followed an evolutionary pattern which is generally typical of the Canadian petroleum industry. In the initial stages, when geological knowledge of the area was limited, risks were high, and only equity capital from foreign sources was attracted. As the Company began to discover reserves and commence production of these reserves, fully secured debt issues and public equity capital were obtained to permit further expansion of operations. Without the tax incentives which were available to attract the initial high risk foreign capital and stimulate continued exploration activities, the Company would not have been able to

EXHIBIT I

develop to its present position. Statistics in our most recent annual report, a copy of which is attached, indicate the growth of the Company. In Table 1, we have presented comparative statistics to indicate the magnitude of the Company's participation in several of the more important phases of the western Canadian petroleum industry. The comparison demonstrates that the Company carries out a substantial portion of the exploration and production activities of the industry and may be considered as being representative of the industry as a whole in these phases of the business.

During the past fifteen years, HBOG has made substantial payments to all levels of Government. These cost items which have been charged to expense are summarized in the following table for the fifteen year period ending in 1969. For comparison purposes the corresponding amounts for the year 1969 are also shown.

TABLE 2

Cost Items	15 Year Period To Dec. 31, 1969	1969
Taxes - Property Taxes	$ 5,856,000	$ 1,104,000
Mineral Tax	3,290,000	515,000
Conservation Board Tax	758,000	68,000
Real Estate & Business Taxes	1,437,000	148,000
Income Taxes (Estimated)	2,360,000	2,360,000
	13,701,000	4,195,000
Lease Rentals	38,328,000	2,767,000
Crown Royalties on Production	55,113,000	7,600,000
TOTAL	$107,142,000	$14,562,000

EXHIBIT I

Of the other direct tax expenditures only the $1,437,000 of Real Estate and Business Taxes paid to city governments actually relate to normal services received for tax payments. These taxes are used to finance public schools, streets, street lighting, garbage disposal, police and fire protection, etc. The $5,856,000 of Property Taxes are paid to rural authorities which, in many instances provide few services to the taxed properties. In these instances it is not unusual for oil companies to pay the entire cost of all services such as waste disposal, roads and fire and other protection.

It is an interesting fact that the Company has paid $758,000 to the Alberta Government as its assessed share of operating the Provincial Oil and Gas Conservation Board, which regulates all operations of the petroleum industry. Very few other industries are required to directly pay costs of government regulatory bodies.

During the fifteen year period the Company earned almost $174 million of which $66 million was distributed to the shareholders and the balance was retained by the Company for re-investment. The cost items paid to Governments ($107 million) were deducted in arriving at the net earnings of $174 million and represent over one-third of the income before deducting such costs. The following table shows the cummulative totals over the fifteen year period and the corresponding items for 1969.

	15 Year Period to December 31, 1969	1969
Income before Cost Items	$280,899,000	$41,592,000
Cost Items paid to Governments	107,142,000	14,562,000
Net Earnings	$173,757,000	$27,030,000
Dividends Paid to Shareholders	$ 66,215,000	$10,647,000

EXHIBIT I

This table also shows that the cost items paid to Governments have exceeded by a substantial margin, the dividends paid to HBOG's shareholders during this period.

In addition to these cost items, the Company paid more than $ 41 million for bonus costs to acquire mineral rights from the Provincial and Federal Governments during the past fifteen years. These expenditures along with the cost items are summarized as follows:

	15 Year Period to December 31, 1969	1969
Cost Items	$107,142,000	$14,562,000
Payments for bonus costs to acquire mineral rights	41,042,000	4,310,000
Total Contributions to Government	$148,184,000	$18,872,000

Exhibit 1

Table 1

COMPARISON OF OPERATING DATA

HUDSON'S BAY OIL AND GAS VS. INDUSTRY

	1969			1968			1967			1966			1965		
	Industry**	HBOG	%	Industry	HBOG	%	Industry	HBOG	%	Industry	HBOG	%	Industry	HBOG	%
Production & Sales *															
Crude Oil & NGL	1,316	54.4	4.1	1,197	49.5	4.1	1,110	47.3	4.3	1,013	42.5	4.2	922	38.9	4.2
Natural Gas Sales	4,060	281.7	6.9	3,540	233.3	6.6	3,145	196.7	6.3	2,817	170.0	6.0	2,644	138.0	5.2
Sulphur Sales	7,050	760.0	10.8	6,191	406.0	6.6	5,997	433.0	7.2	4,930	386.0	7.8	4,981	343.0	6.9
Wells Drilled															
Exploratory	1,324	52.0	3.9	1,495	38.2	2.6	1,341	61.2	4.6	1,447	58.5	4.0	1,470	40.3	2.7
Development	1,793	58.0	3.2	1,500	42.4	2.8	1,537	55.9	3.6	1,605	56.7	3.5	2,163	59.7	2.8
Total	3,117	110.0	3.5	2,995	80.6	2.7	2,878	117.1	4.1	3,052	115.2	3.8	3,633	100.0	2.8
Revenue - $ Millions	1,442	69.8	4.8	1,338	60.9	4.6	1,217	56.7	4.7	1,080	48.9	4.5	968	43.6	4.5
Expenditures for Finding & Developing Reserves - $ Millions	920	47.2	5.1	798	56.4	7.1	786	36.1	4.6	704	29.5	4.2	679	31.5	4.6

* Production Data Reported as Follows:

Crude oil and natural gas liquids - Thousands of barrels daily
Natural gas - Millions of cubic feet daily
Sulphur - Long tons daily

Per CPA Statistical Year Book

** Estimated

EXHIBIT II

PIPE LINE RIGHTS-OF-WAY

A right-of-way is the right to gain access to land which is owned by another person and should not be construed to mean ownership of the surface of the land or improvements thereto. Such a right grants unto the holder the privilege to use the surface of the land; the holder must pay for any resulting damages whenever he enters the right-of-way.

A pipe line right-of-way is a narrow corridor over the length of the pipe line which is acquired for the purpose of laying and maintaining the line. The rights are acquired from various surface rights owners at values established by negotiation or arbitration.

Upon completion of construction, the surface is restored and the owner of the land uses the surface as desired, subject to certain restrictions regarding the placing of buildings or improvements within the limits of the rights-of-way. The majority of such rights are seldom used after the construction period except for repair of line breaks. Rights-of-way are held for the life of the pipe line and in all cases, can be surrendered at the holder's option. In some instances, depending on the nature of the instrument, rights-of-way can be terminated by the grantor.

Pipe line rights-of-way, in Alberta, are secured through three basic types of instruments. A brief description of each instrument and its provisions are as follows:

1) Easements

An easement provides the holder with a permanent right or estate in land but only for the construction and operation of

EXHIBIT II

the pipe line and until it is discharged. Easements are not terminable, but can be surrendered by the holder.

2) Public Utilities Board Order

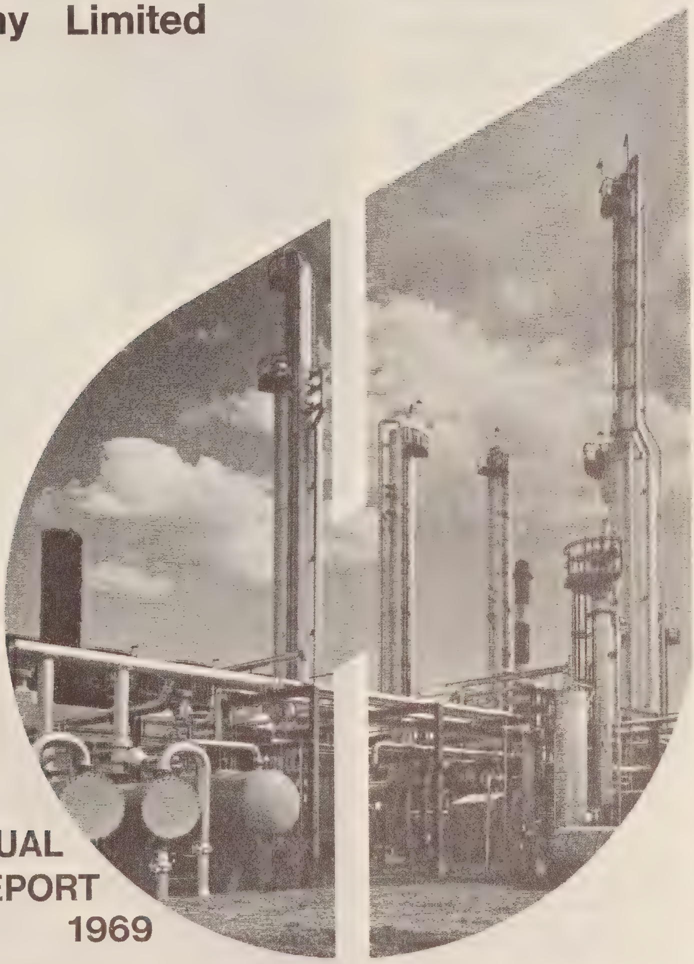
A right-of-way acquired through a Board Order grants rights similar to those of an easement which exist for the life of the project and are terminable by the Board on application by either party.

3) Pipe Line Agreement

Pipe line agreements are granted by the Government giving rights similar to an easement and are terminable when use ceases, or on application by the holder.

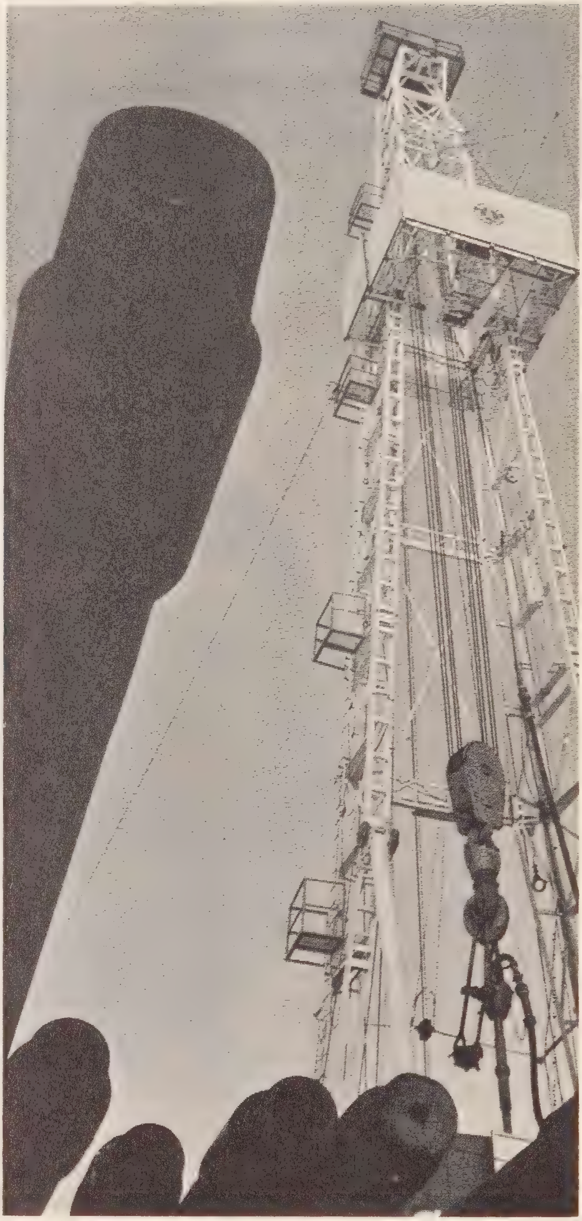
A pipe line right-of-way involves an expenditure to acquire a right of access to service a pipe line. It does not give the holder the privilege of using the surface of the land for any purpose other than for earning income from the pipe line. Even then, right of access is subject to payment for any damages caused to the soil, crops, fences, etc., and when the pipe line operations cease, the holder does not have an asset which he can sell.

Hudson's Bay Oil and Gas Company Limited



ANNUAL
REPORT
1969

Hudson's Bay Oil and Gas Company Limited



1969 Annual Report

CONTENTS

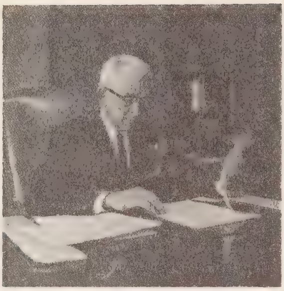
ANNUAL MEETING OF SHAREHOLDERS

The Annual Meeting of Shareholders will be held at the Head Office of the Company on Tuesday, April 21, 1970 at 11:30 a.m. Notice of the meeting and proxy forms are being mailed with this report.

FINANCIAL AND OPERATING HIGHLIGHTS

	1969	1968	Increase (Decrease) Per Cent
FINANCIAL			
Gross Operating Revenues	$76,495,000	$66,884,000	14.4
Funds Generated from Operations			
Total	$44,794,000	$42,751,000	4.8
Per Common Share	$ 2.37	$ 2.25	5.3
Net Earnings before Income Taxes	$29,390,000	$26,810,000	9.6
Net Earnings			
Total	$27,030,000	$26,790,000	0.9
Per Common Share	$ 1.40	$ 1.38	1.4
Dividends Declared			
Total	$10,647,000	$10,647,000	–
Per Preferred Share	$ 2.50	$ 2.50	–
Per Common Share	$ .50	$ .50	–
Capital and Exploration Expenditures	$49,117,000	$60,695,000	(19.1)

	1969	1968	Increase (Decrease) Per Cent
OPERATING			
Crude Oil and Natural Gas Liquids			
Production – Net (Barrels per day)	54,426	49,515	9.9
Natural Gas Sales – Net			
(Millions of cubic feet per day)	281.7	233.3	20.7
Sulphur Sales – Net (Long tons per day)	760	406	87.2
Pipe Line Throughput (Barrels per day)	70,135	66,578	5.3
Oil and Gas Rights (net acres at year end)	22,831,000	20,676,000	10.4
Proved and Probable Reserves – Net (at year end)			
Crude Oil and Natural Gas Liquids (Barrels)	386,795,000	376,137,000	2.8
Natural Gas (Millions of cubic feet)	3,181,000	3,134,000	1.5
Sulphur (Long tons)	9,760,000	9,490,000	2.8



PRESIDENT'S REPORT

In 1969 Hudson's Bay Oil and Gas again achieved substantial gains in operating volumes and revenues. However, its long record of substantial annual gains in net earnings was interrupted by the impact of income taxes which previously had been a negligible factor due to accumulated deductions for drilling and exploration expenditures carried forward from prior years.

Financial Results

Net earnings for 1969 were $27,030,000, approximately 1% higher than in the prior year, and after deducting preferred dividends amounted to $1.40 per common share as compared with $1.38 per share in 1968. Earnings before providing for $2,360,000 of income taxes were up 9.6%. Funds generated from operations, after providing for income taxes, increased by 4.8% to $44,794,000 and were equivalent to $2.37 per common share after deducting preferred dividends as compared with $2.25 per share in 1968.

Gross operating revenues for the year totalled $76,495,000, an increase of 14.4%. Most of this gain was attributable to sales of additional volumes of natural gas and natural gas liquids produced from new gas processing plants that were brought into operation late in 1968 and early in 1969. These new plants also contributed to a large increase in the Company's production and sales of sulphur, but sulphur revenues were only moderately higher than in 1968 because of a sharp decline in prices.

Capital and Exploration Expenditures

Capital and exploration expenditures for the year totalled $49,117,000. These outlays, although considerably greater than in most prior years, represented a reduction of $11,578,000 from the particularly high level of spending in 1968 when five major gas plant projects were under construction. In 1969 expenditures for gas plants and related facilities totalled $8,663,000 with the principal item being the Company's share of the costs of constructing a second large plant in the Kaybob South gas field. This plant has been brought into operation since year end and will add

materially to the Company's production volumes and revenue generation in 1970. Expenditures on acreage acquisitions totalled $14,171,000 for the year, more than double the $5,766,000 spent in 1968. Most of the increase was for the purchase of a substantial interest in 3,717,000 acres of permits in the Arctic Islands. These permits form part of the lands on which Panarctic Oils Ltd. is currently carrying out geological, geophysical and exploratory drilling programs under farmout agreements. Early and important evaluation of the Company's Arctic Islands holdings will result from these programs.

Financing

Early in the year the Company sold U.S. $25,000,000 of 7.85% Collateral Trust Bonds due 1994. This financing provided additional funds for prospective capital spending requirements and at year end the Company was in strong liquid position with $33,234,000 of cash and short term investments.

Plans for 1970

Capital and exploration expenditures in 1970 are expected to be maintained at approximately the same level as in 1969. Outlays for acreage acquisitions and for development drilling and production facilities are projected at normal levels. Expenditures for exploratory drilling are expected to be higher than in 1969 as two expensive exploratory tests are scheduled to be drilled on the Company's holdings in the offshore areas between Nova Scotia and Prince Edward Island. Spending on gas plants and related facilities also will be somewhat higher than in 1969 with the major item being the Company's share of the cost of constructing a third plant at Kaybob South to serve the southern portion of the field. Completion of this plant, currently projected for mid 1971, will result in a substantial addition to the Company's natural gas, gas liquids and sulphur production.

Industry Outlook

The outlook for the Canadian petroleum industry appears generally favourable. Demand for Canadian crude oil and natural gas liquids grew by almost 10% in 1969. A substantial increase in exports to the United States was a major factor in this market growth. The strong uptrend in export demand has continued in 1970 to date but any realistic forecast of the average level of export demand for the year must await clarification of the position of the United States Government with respect to its oil import program. Domestic demand for Canadian crude oil and equivalents is expected to increase by approximately 4% in 1970 as compared with a 3.8% gain in 1969. Steady growth in demand for natural gas in both domestic and export markets resulted in a 15% increase in sales in 1969 and another increase of similar magnitude in 1970 is indicated. The expansion of gas processing in 1970 to meet the increased demand will result in another large addition to Canadian sulphur production. This undoubtedly will further compound the existing over-supply situation and probably will preclude any significant strengthening of the currently depressed price for sulphur. The industry's exploratory drilling activities in 1969 resulted in a number of significant gas discoveries in the deep Alberta basin along the eastern edge of the foothills belt but no new oil discoveries of major importance have been reported. However, exploratory drilling is expected to be maintained at a high level in 1970 as the industry tests the extensive new land holdings acquired in recent years and increases its drilling activity in the new frontier areas of Canada's far north and off its East Coast.

Proposed Tax Changes

In November the Government of Canada issued a White Paper setting out proposals for a wide-ranging reform of income taxes. Some of the changes proposed in general taxing provisions could have very damaging consequences for the petroleum industry and the Canadian economy as a whole. The revolutionary proposals for integration of corporate and personal income taxes, and for the taxing of unrealized capital gains at periodic intervals, could seriously disrupt the financing of the productive new capital investments that are

essential to continued strength and growth of the economy. Healthy and effective capital markets are particularly important to the petroleum industry because it is so capital intensive. The White Paper proposals that deal specifically with the petroleum industry would introduce additional restrictions on depletion allowances. However, over the foreseeable future, the proposed restrictions probably would not have any significantly limiting effect on the amount of depletion that could be claimed by exploration-oriented companies such as Hudson's Bay Oil and Gas. The Government has requested submissions on these proposals and the Company plans to present a brief stating its views. Hopefully the opinions and recommendations submitted by individual and corporate taxpayers will result in elimination or modification of some of the more extreme White Paper proposals when the Government introduces a revised Income Tax Act, currently projected for 1971.

Directors and Employees

In December, 1969, the Directors accepted with sincere regret the resignation of Mr. M. J. Foley who had served as a member of the Board since 1960. Mr. John G. McLean was appointed a Director to fill this vacancy on the Board. Mr. McLean is President and Chief Executive Officer of Continental Oil Company.

The success achieved by the Company reflects the competence with which employees throughout the organization have performed their functions. The Directors again wish to express their appreciation to the employees.

Submitted on behalf of the Board of Directors:

L. J. Richards

President

Calgary, Alberta
February 24, 1970


GENERAL REVIEW

EXPLORATION REVIEW

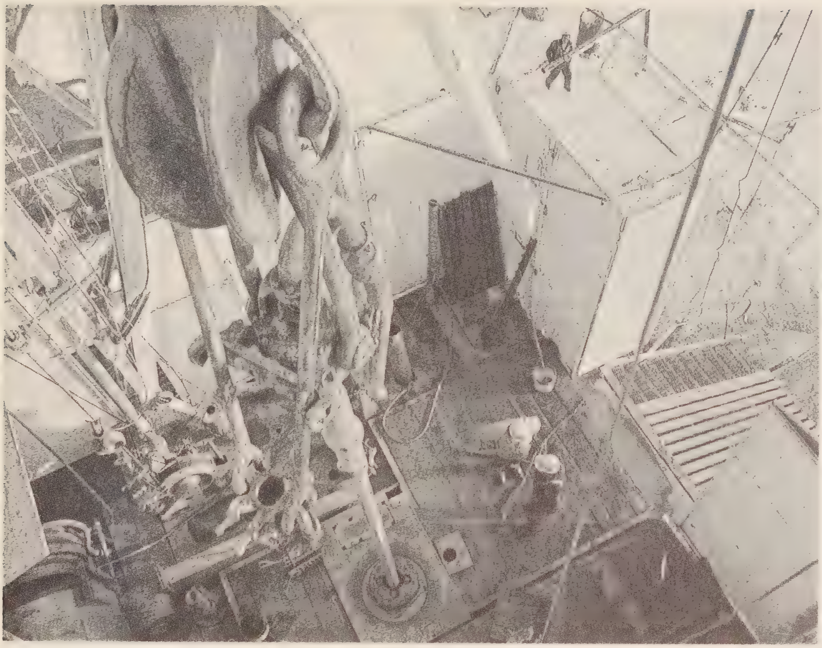
General – The Company's exploration expenditures totalled $27,640,000 in 1969. This was 42% more than the $19,408,000 spent for exploration in the previous year. Most of the increase was a result of large outlays for interests in widespread exploratory acreage in the Arctic Islands. Acreage acquisition costs totalled $14,171,000, an increase of $8,405,000. Exploratory drilling expenditures, at $4,031,000, were down $1,272,000 but a high level of geophysical activity was maintained at a cost of $4,604,000, up $466,000. Good progress was made in assembling a staff of mineral exploration specialists and a modest program of exploration for uranium and base metals was carried out during the year at a total cost of $548,000.

As in previous years, a large share of the Company's petroleum exploration activities were conducted in Alberta, British Columbia, Saskatchewan and the southern portion of the Northwest Territories. Through its Arctic Islands acreage purchase the Company acquired a strong position in the new exploratory play developing in that area, and it also participated in marine geophysical surveys in the Arctic covering its holdings in the Beaufort Sea. During the year additional geophysical surveys were carried out on the Company's land holdings in the Maritimes and locations have been selected for two exploratory tests to be drilled in 1970 on 50% owned acreage in the offshore areas between Nova Scotia and Prince Edward Island.

Discoveries and Extensions — The Company participated in 17 successful exploratory tests in 1969, of which eight were completed as oil wells and nine as gas wells. However, all of the oil wells and two of the gas wells were drilled by others on relatively small blocks of acreage that had been farmed out to them by the Company and it appears unlikely that these discoveries will lead to the development of any significant volumes of reserves. The remaining seven gas discoveries and extensions will require additional drilling to properly evaluate their potential.

At Marlboro in west central Alberta, the Company participated in an Upper Devonian Leduc Reef gas discovery. This well was drilled approximately one mile southwest of a discovery made in 1965 and added to the gas reserves established in this field. The Company owns a 41⅔% interest in the 15,040 acre block on which these wells are located and has a similar interest in several adjacent blocks of lease and reservation acreage.

In northeastern British Columbia, the Company drilled a successful four mile southeasterly extension to the Cypress gas field. Negotiations are currently underway to obtain a gas sales contract for the reserves in this field which is



located approximately 20 miles west of the existing trunk pipe line system owned by Westcoast Transmission Company Limited.

In the Sylvan Lake-Caroline area of central Alberta the Company participated in two gas discoveries, both of which are being further evaluated by follow-up wells. In each case, the Company owns a 50% interest in the lands on which the discovery was drilled and also has varying interests in other sizeable blocks in the immediate area of these discoveries.

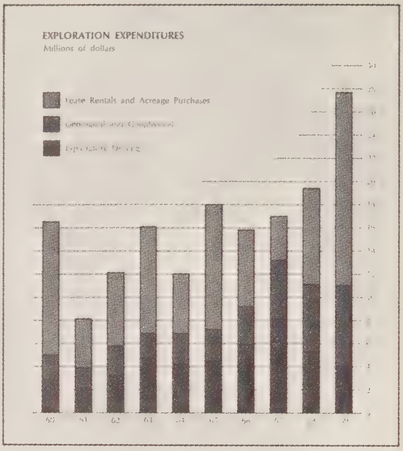
The Company also participated in gas discoveries or extensions at Evergreen in northeastern British Columbia, Innisfail in Central Alberta and Plato in southwestern Saskatchewan and has interests varying from 100% to 31% in the tracts on which these tests were drilled.

Acreage Holdings — During 1969 the Company acquired 4,189,000 acres of petroleum and natural gas rights, of which 2,713,000 acres were purchased at a cost of $14,171,000 and 1,476,000 acres were obtained through filing and other acquisitions that did not require bonus payments.

The largest and most significant acquisition was the purchase of an interest in 3,717,000 acres in the Arctic Islands comprising large permit blocks on Bathurst, Cornwallis, Melville, Lougheed, Axel Heiberg and Ellesmere Islands. All of these holdings are subject to a farmout agreement under which Panarctic Oils Ltd. has committed to drill a minimum of four wells and has an option to drill an additional seven wells to earn varying interests in the blocks on which the tests are located.

Dependent upon the number of wells drilled under this farmout program, the Company's net interests in this acreage will be in the range of 17% to 25%. As consideration for these interests, the Company agreed to pay the permit holder a total of $9,000,000 cash plus an assignment of a 50% interest in 63,000 lease acres in the Panny River area of northern Alberta and a 38% interest in 491,000 permit acres near Fort Simpson in the Northwest Territories.

Other significant acreage acquisitions during the year included purchases in Alberta of a 41⅔% interest in an 11,840 acre drilling reservation at Marlboro for $1,295,000, a 12,800 acre drilling reservation in the Strachan area for $375,000 and 43,360 reservation acres in the Senex area for $661,000. In Saskatchewan 271,000 permit acres were acquired in the Plato area at a cost of $273,000. In northeastern British Columbia the Company purchased a total of 148,000 permit acres for $978,000 and, in the central part of the province, filed on 240,000 acres in the Bowser Basin and 1,020,000 acres in the Chilcotin area.



During the year the Company surrendered or released its interests in 2,034,000 acres of petroleum and natural gas rights. These included 934,000 acres released after geological and geophysical evaluation, 630,000 acres surrendered under governmental regulations on conversion of permits and reservations to lease status, and interests equivalent to 470,000 net acres assigned to other companies in return for drilling wells on Company lands. In addition, 40,000 acres were transferred to the developed category.

At year end the Company held 22,319,000 net acres of undeveloped petroleum and natural gas rights acquired at a total cost of $45,036,000, or an average of $2.02 per acre. Rental payments in 1969 totalled $2,483,000.

UNDEVELOPED PETROLEUM AND NATURAL GAS RIGHTS

Net Acreage Holdings as of December 31, 1969

Location	Crown Permits or Reservations (1)	Leaseholds	Hudson's Bay Company Lands (2)	Fee Lands	Total
Alberta	465,000	1,958,000	1,497,000	85,000	4,005,000
Saskatchewan	1,914,000	399,000	2,327,000	102,000	4,742,000
British Columbia	1,744,000	641,000	6,000	—	2,391,000
Northwest Territories (including Arctic Islands)	5,189,000	8,000	—	—	5,197,000
Maritimes	5,195,000	—	—	—	5,195,000
Manitoba	—	—	700,000	89,000	789,000
	14,507,000	3,006,000	4,530,000	276,000	22,319,000

(1) Convertible into leases to the extent of approximately 50%.

(2) Held under an agreement which permits conversion to leases at any time up to December 31, 1999 without payment of any bonus.

DRILLING REVIEW

During 1969 the Company participated in drilling 244 wells, 78 more than in the previous year. In addition to its direct drilling participation, royalty interests were retained in 40 wells drilled on properties farmed out to others.

Exploratory completions in the year totalled 89 gross wells, an increase of 31 over the number completed in 1968. The 1969 completions include 56 farmout wells in which all or part of the drilling costs were borne by the farmees in exchange for an interest in the lands on which the wells were drilled. Through these farmouts the Company participated in 12 discoveries in which its interests are equivalent to 5.4 net wells. The geographical distribution of the exploratory completions was 26 in Alberta, 51 in Saskatchewan, 7 in the Northwest Territories and 5 in British Columbia.

In 1969, 58.0 net development wells were completed, an increase of 15.6 wells over the prior year. Oil well completions totalled 31.5 net wells, up 12.2 wells. Continued development in the Zama Lake field and infill drilling in the Pembina field accounted for a high percentage of the oil well completions. Gas well completions totalled 19.8 net wells, an increase of 3.6 net wells, with the most active area of gas development being the Kaybob South Beaverhill Lake field.

WELL COMPLETIONS

	1969		1968	
	Gross	Net	Gross	Net
Exploratory				
Oil	8	4.0	6	4.8
Gas	9	4.9	7	3.9
Dry	72	43.1	45	29.5
Total	89	52.0	58	38.2
Average Depth		4,980′		6,515′
Development				
Oil	61	31.5	33	19.3
Gas	77	19.8	61	16.2
Dry	17	6.7	14	6.9
Total	155	58.0	108	42.4
Average Depth		4,650′		6,109′

PRODUCTION REVIEW

Crude Oil — The Company's net crude oil production averaged 42,478 barrels per day in 1969, essentially unchanged from the previous year. Increases in production resulting from improved markets, new wells, and a full year's operation of wells completed in 1968 were almost entirely offset by declines. The most significant reduction occurred at Zama Lake where allowable production rates declined because of downward revisions in the estimated reserves recoverable by primary production methods. It is anticipated that these production rates will increase substantially on completion of the enhanced recovery scheme discussed below.

The average wellhead price received by the Company for its 1969 crude oil production was $2.37 per barrel, a slight improvement over the

CRUDE OIL PRODUCTION — NET
(Barrels Per Day)

	1969	1968
Alberta		
Pembina	7,734	7,543
Zama Lake	4,839	5,382
Virginia Hills	2,081	1,745
Sundre	1,545	1,655
Sturgeon Lake South	1,461	1,436
Cessford	1,360	1,093
Kaybob South	1,232	1,353
Medicine River	1,126	1,336
Bonnie Glen	933	822
Innisfail	831	879
Nipisi	715	441
Fenn Big Valley	694	601
Other Fields	7,281	7,518
Total	31,832	31,804
British Columbia		
Milligan Creek	3,959	3,804
Peejay	1,575	1,397
Other fields	566	509
Total	6,100	5,710
Saskatchewan		
Hummingbird	838	885
South Success	779	979
Other fields	2,910	3,055
Total	4,527	4,919
Manitoba	19	19
Total	**42,478**	**42,452**

1968 average price of $2.35 per barrel. This increase reflects modestly higher wellhead prices in a number of fields arising from pipe line tariff adjustments.

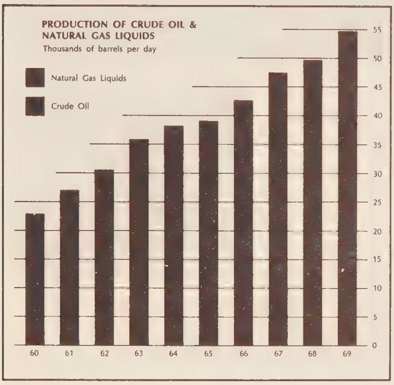
Six enhanced recovery projects, which are designed to improve or maintain producing rates and ultimately recover a larger percentage of the oil in place in the reservoir, were completed in 1969. Three of these projects were in pools in the Pembina field, one was in the Nipisi field and one in the Joffre field — all in Alberta — and one was in the Delta field in Saskatchewan. Engineering studies and pilot field tests to evaluate the feasibility of a large scale enhanced recovery scheme for the Zama Lake field have now been completed and indicate that a very substantial increase in recoverable reserves can be obtained. Application for approval to proceed with the project is being made to the Alberta Oil and Gas Conservation Board. Following approval, it will take approximately two years for construction and implementation of the scheme. When the system becomes fully effective, the Company's allowable production rates from Zama Lake will be materially increased.

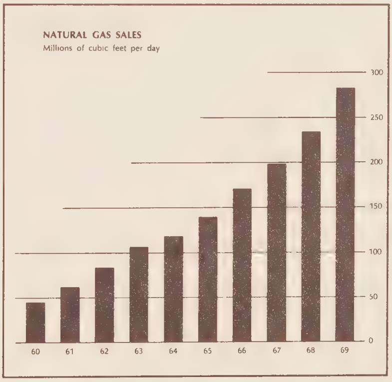
Economies can be achieved by consolidating the operations of various owners within a pool as one unit. Accordingly, the Company continued its active program of unitization and participated in the formation of 20 units in 1969. At year end the Company had interests in 174 units and was the designated operator of 27 of them.

Natural Gas and Associated Products — New additions to the Company's natural gas processing facilities completed in the latter part of 1968 and early in 1969 resulted in a record volume of production and sales of natural gas, natural gas liquids and sulphur for the year. The growing importance of this segment of the Company's operations is demonstrated by the fact that it generated 43% of total gross operating revenues for 1969 as compared with only 36% in the previous year and 26% five years ago.

In 1969, sales of natural gas averaged 281.7 million cubic feet per day, an increase of 48.4 million cubic feet per day or 21%. The major part of this gain is accounted for by sales from the new Brazeau River and Kaybob South No. 1 gas plants which were brought on stream early in 1969 and from a full year's operation of the Caroline plant which commenced operations in the fall of 1968. The average price obtained for 1969 gas sales was 15.3 cents per thousand cubic feet as compared with 14.6 cents in 1968.

Production of natural gas liquids averaged 11,948 barrels per day, an increase of 4,885 barrels per day or 69% over the prior year. Condensate production, at an average of 10,058 barrels per day, was up 3,967 barrels per day or 65% and production of LPG (propane and butane) averaged

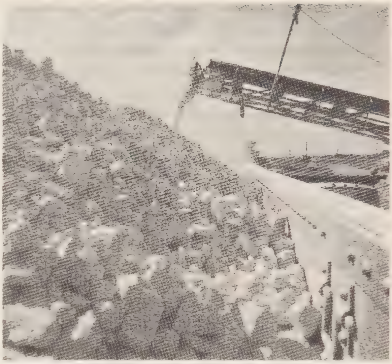


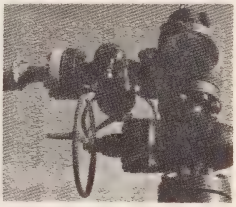


1,890 barrels per day, a gain of 918 barrels per day or 94%. As shown by the accompanying table, most of these increases represented production from new plants.

The average plant price realized from 1969 sales of condensate was $2.70 per barrel as compared with $2.74 per barrel in the prior year with the change resulting from minor price variations between the various plant locations. The average plant price received for sales of LPG declined to $1.08 per barrel as compared with $1.49 for 1968 caused partially by high interim shipping costs incurred while permanent transportation facilities from new plants were under construction. Also, LPG prices were weak early in 1969 during a period of oversupply but by year end prices had improved with increased demand for LPG. Current market conditions indicate somewhat higher average prices will prevail in 1970.

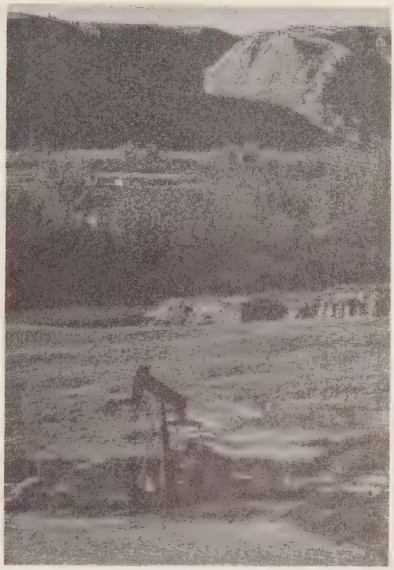
Sulphur production totalled 348,535 long tons (an average of 955 long tons per day) in 1969, an increase of 165,558 long tons or 90%. Most of the increase was from new production at the Kaybob South plant and higher sulphur recoveries at the West Whitecourt plant. With severe oversupply conditions prevailing in world sulphur markets, the Company was unable to dispose of all of its production but did increase its sales by 128,999 long tons or 87% to a total of 277,451 long tons. Revenues from these sales, however, increased by only 6.7% reflecting the continuing sharp decline in world sulphur prices. All of the Company's Whitecourt sulphur production is sold under a long term contract which provides that the hydrogen sulphide contained in the natural gas produced from the field will be converted to sulphur in the purchaser's plant with the Company receiving one-half of the sales value of this sulphur. Production and sales from West Whitecourt totalled 154,071 long tons in 1969, an increase of 64,394 long tons or 72%, and the average net price received was $12.51 per long ton as compared with $19.25 per long ton in 1968. The Company's sales of sulphur from plants where it has an ownership interest in the sulphur extraction facilities totalled 123,380 long tons, an increase of 64,605 long tons or 110%. The average price obtained for sulphur sales from these plants was $19.00 per long ton in 1969 as compared with $38.76 in the previous year.





Top picture: Loading sulphur into rail cars
Centre: Loading LPG for rail shipment
Above right: Wellhead on a gas producer in the Lone Pine Creek Field

Further expansion of the Company's gas processing facilities was achieved in 1969 with the principal additions being a second major gas plant and gathering system at Kaybob South to process reserves from the central portion of the field, an expansion of the Edson gas plant, and the construction of a gas processing and crude oil upgrading facility for the Sturgeon Lake South field, all of which are operated by the Company. The new Sturgeon Lake South and Edson facilities were completed and brought into operation in September and November of 1969 respectively, adding 13 million cubic feet of natural gas, 150 barrels of natural gas liquids and 13 long tons of sulphur to the Company's daily net production.



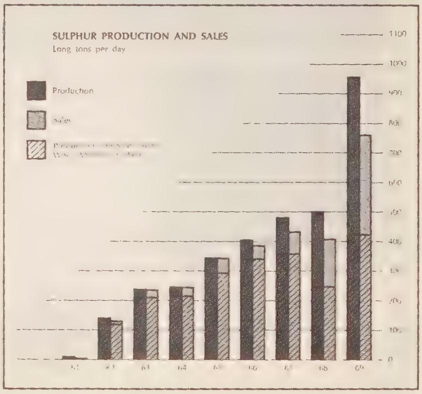
Producing oilwell in the "Badlands" near Drumheller

NATURAL GAS AND ASSOCIATED PRODUCTS — NET

	Natural Gas Sales (Million Cubic Feet Per Day)		Natural Gas Liquids Production — Condensate (Barrels Per Day)		Natural Gas Liquids Production — L.P.G. (Barrels Per Day)		Sulphur Production (Long Tons Per Day)	
Location	**1969**	**1968**	**1969**	**1968**	**1969**	**1968**	**1969**	**1968**
Bigstone	3.5	1.4	–	–	–	–	35	20
Brazeau	26.8	–	461	–	–	–	11	–
Caroline	15.0	4.3	503	171	323	83	4	2
Cessford	41.1	41.3	114	98	–	–	–	–
Clarke Lake	17.7	17.3	–	–	–	–	–	–
Crossfield East	2.6	1.3	29	27	–	–	53	43
Edson	53.1	60.5	636	527	–	–	41	41
Gilby	4.7	4.0	64	46	–	–	–	–
Harmattan	–	–	401	406	218	219	–	–
Kaybob South	5.6	0.3	2,887	94	484	–	205	–
Lone Pine Creek	16.3	11.8	648	340	–	–	69	30
Pembina	7.8	9.7	26	36	76	92	–	–
Provost	4.4	4.6	16	19	–	–	–	–
Rimbey	6.2	6.1	298	282	296	303	6	6
Sylvan Lake	10.1	9.5	223	169	374	151	–	–
Whitecourt	35.0	31.3	3,310	3,463	–	–	485	318
Wildcat Hills	3.8	3.2	31	28	–	–	6	5
Wimborne	2.2	2.2	129	110	–	–	18	13
Other locations	25.8	24.5	282	275	119	124	22	22
	281.7	233.3	10,058	6,091	1,890	972	955	500

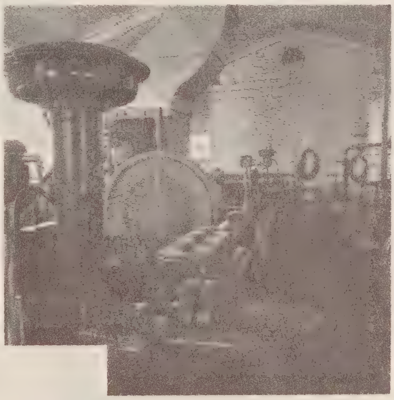
Caroline gas processing plant
with sulphur storage block
in the foreground

The Kaybob South No. 2 plant has been brought into operation since the year end and the Company's net share of the output of this plant is expected to average about 3.6 million cubic feet of natural gas, 1,800 barrels of natural gas liquids and 165 long tons of sulphur per day for 1970. The Company also will have a substantial ownership interest in a third major plant at Kaybob South which is being constructed and will be operated by another company to serve the southern portion of the field. This No. 3 plant, which will have a capacity approximately 30% larger than the combined capacity of the Kaybob South No. 1 and No. 2 plants, is scheduled for completion in 1971.



Reserves – The Company's net remaining recoverable reserves at year end (after deducting all royalties and interests owned by others) as estimated by its reservoir engineering staff are shown in the accompanying table. The estimated proved reserves include only such reserves as can reasonably be classified as proved in accordance with widely accepted American Petroleum Institute standards. Probable reserves include reserves which are substantially proved on undrilled tracts closely associated with proved reserves and for which geological control is sufficient to offer good indication of continuity of the producing horizon. Incremental reserves from enhanced recovery techniques are included in the probable category when the required facilities are installed and are transferred to the proved category only after the anticipated reservoir performance has been confirmed. Liquefied petroleum gases are not included in the reported reserves of natural gas liquids unless the facilities required for their extraction are in existence or are assured of construction. Heavy oil in the Athabasca Tar Sands and Frenchman Butte areas has not been included.

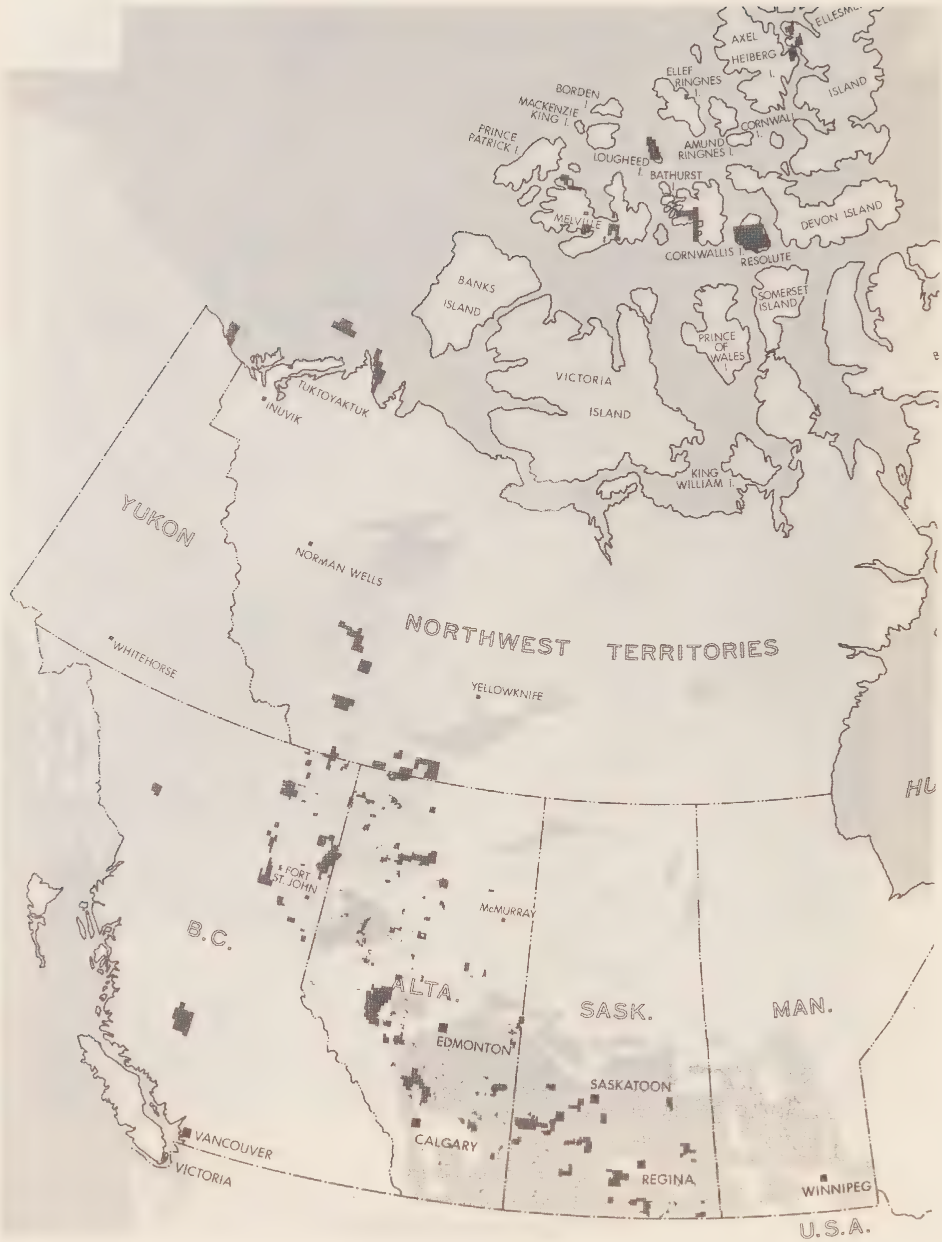
In 1969 additions to the Company's liquid hydrocarbon reserves totalled 30,523,000 barrels as compared with total production of 19,865,000 barrels, for a resulting net gain of 10,658,000 barrels in remaining recoverable reserves. Most of the additions were in natural gas liquids while crude oil accounted for approximately three quarters of the production volume. As a result, the net change for the year in remaining recoverable reserves was an increase of 17,646,000 barrels in the case of natural gas liquids and a decrease of 6,988,000 barrels for crude oil. Additions to natural gas reserves totalled 150 billion cubic feet as compared with production of 103 billion cubic feet during the year with a consequent increase of 47 billion cubic feet in remaining recoverable reserves. Additions to sulphur reserves substantially exceeded the 349,000 long tons produced in 1969 and the net gain in remaining recoverable reserves was 270,000 long tons.

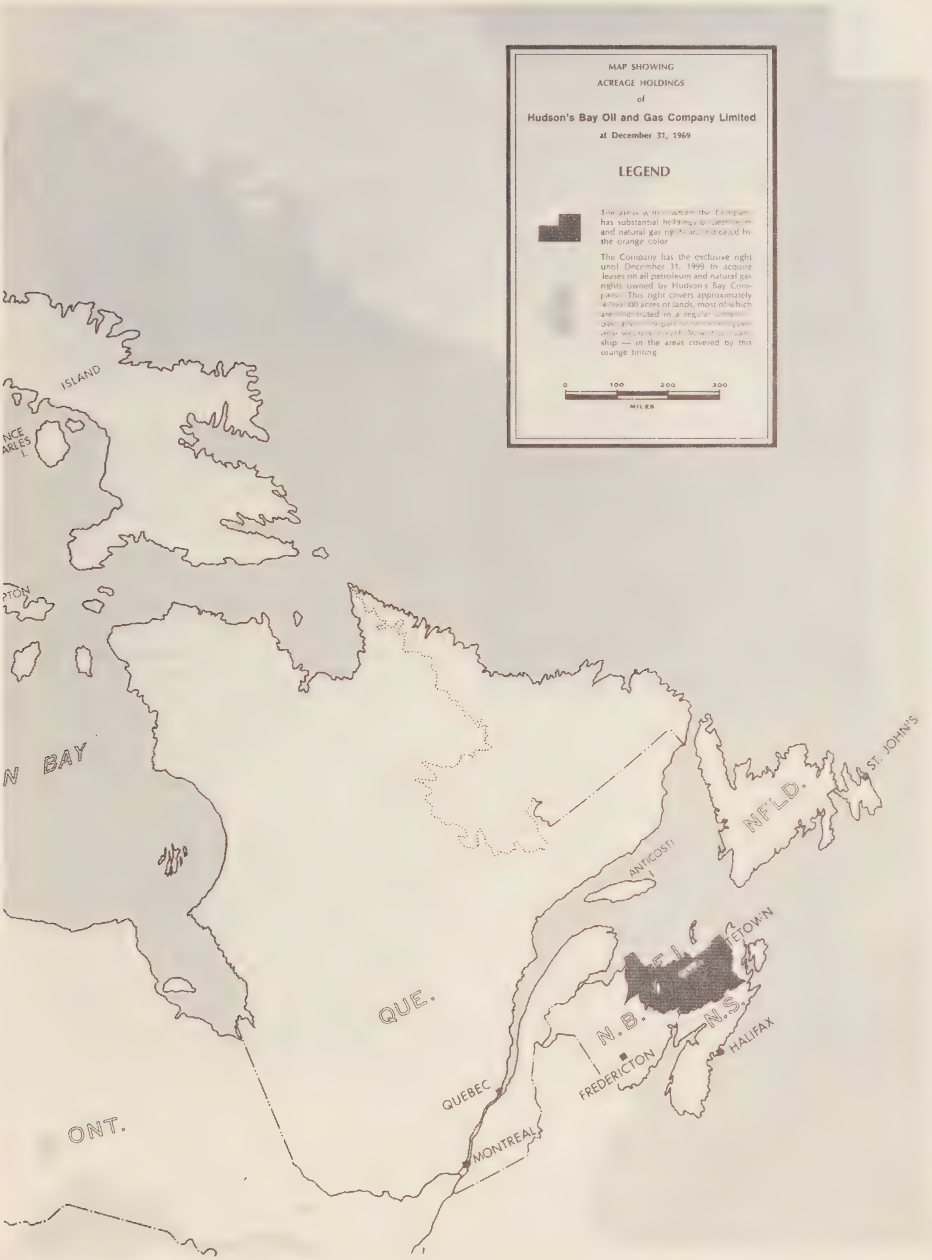


NET RESERVES
December 31, 1969

	Crude Oil (barrels)	Natural Gas Liquids (barrels)	Natural Gas (million cubic feet)	Sulphur (long tons)
Proved	258,206,000	102,488,000	2,899,000	8,818,000
Probable ..	23,770,000	2,331,000	282,000	942,000
Total	281,976,000	104,819,000	3,181,000	9,760,000

Top picture: High pressure well head in the Kaybob South gas field
Above: Interior view of the waterflood station in the Sundre oilfield


AXEL
HEIBERG
I.
ISLAND
ELLEF
RINGNES
I.
BORDEN
I.
MACKENZIE
KING I.
PRINCE
PATRICK I.
CORNWALL
I.
AMUND
RINGNES I.
LOUGHEED
I.
BATHURST
I.
MELVILLE
I.
DEVON ISLAND
CORNWALLIS I.
RESOLUTE
BANKS
ISLAND
SOMERSET
ISLAND
PRINCE
OF
WALES
I.
VICTORIA
ISLAND
TUKTOYAKTUK
INUVIK
KING
WILLIAM I.
YUKON
NORMAN WELLS
NORTHWEST TERRITORIES
WHITEHORSE
YELLOWKNIFE
FORT
ST. JOHN
McMURRAY
B.C.
ALTA.
SASK.
MAN.
EDMONTON
SASKATOON
CALGARY
VANCOUVER
VICTORIA
REGINA
WINNIPEG
U.S.A.


MAP SHOWING
ACREAGE HOLDINGS
of
Hudson's Bay Oil and Gas Company Limited
at December 31, 1969
LEGEND
the orange color
The Company has the exclusive right
until December 31, 1999 to acquire
leases on all petroleum and natural gas
rights owned by Hudson's Bay Com-
This right covers approximately
acres of lands, most of which
ship — in the areas covered by this
orange tinting
0 100 200 300
MILES
ISLAND
BAY
ONT.
QUE.
QUEBEC
MONTREAL
ANTICOSTI I.
NFLD.
ST. JOHN'S
N.B.
FREDERICTON
N.S.
HALIFAX

SUPPLY AND TRANSPORTATION REVIEW

Pipe Lines – During 1969 the Company's pipe line systems gathered and transported an average of 70,135 barrels per day of crude oil and natural gas liquids, an increase of 3,557 barrels per day or 5.3% over the previous year. The larger throughput volume resulted in an 8.4% increase in transportation revenues.

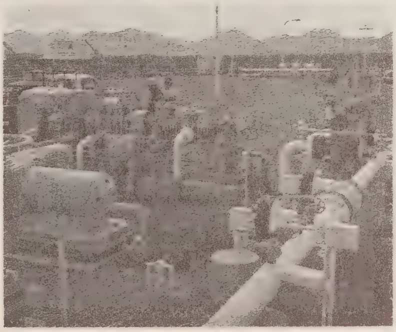
Expenditures for additions and extensions to the Company's systems amounted to $938,000 and brought total investment in pipe line properties to $30,713,000 at year end. At that time, these properties included 420 miles of trunk line and 425 miles of gathering facilities plus an additional 23 miles of 6-inch gathering line under construction at year end to connect a new oil field in the Ricinus area to the Sundre station. This extension is scheduled for initial operation early in 1970.

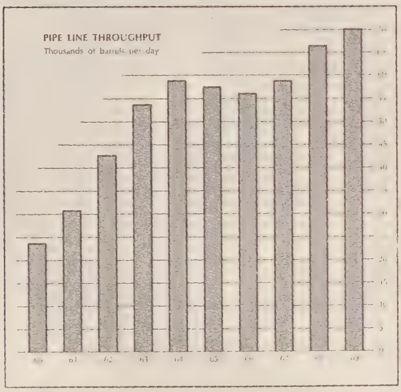
The Company maintained its investment interests of 16% in Peace River Oil Pipe Line Co. Ltd., and 4% in Producers Pipelines Ltd. These producer-owned systems operate extensive crude oil gathering and trunk line facilities in northern and north central Alberta, and in southeast Saskatchewan respectively.

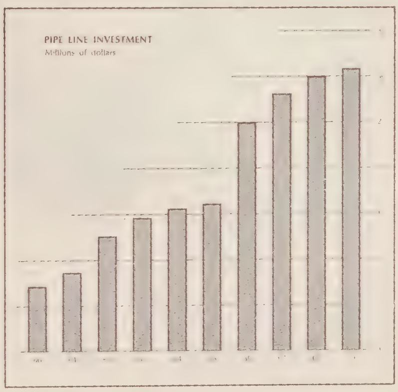
Other Operations – Further expansion was achieved during 1969 in the Company's crude oil trading operations and wholesale marketing and transportation of LPG. Crude oil trading volumes and the requirements of refinery customers served by this operation increased significantly. The volume of LPG's handled also rose substantially as a result of increased production of these products from the Company's gas plant operations.

The retail propane business carried on by the Company's wholly-owned subsidiary, Blue Flame Propane Ltd., also showed good growth in 1969 and its area of operations was expanded by opening new branches in Vancouver, British Columbia, Grande Prairie, Alberta, and Grenfell, Saskatchewan. The volume of propane sold through the Blue Flame operation was 10.1 million gallons, an increase of 1.8 million gallons or 22% from the previous year. These sales provided a market for almost 63% of the Company's total propane production.

Above: Transporting propane
At right: Pipeline pumping station
at Pincher Creek

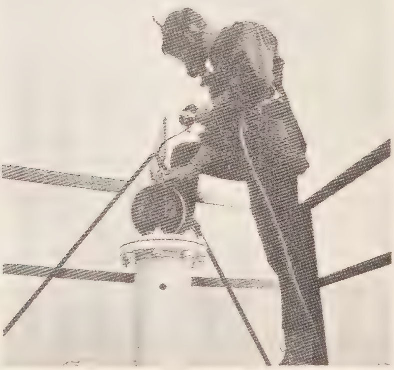






EMPLOYEES

Below: Electrical maintenance at the Kaybob South gas plant Bottom picture: Gauging a crude oil storage tank



At year end the Company and its subsidiaries had a total of 938 employees, an increase of 89 from the beginning of the year. A large share of the additions during the year were required to staff two new gas plants. The total cost of salaries, wages and employee benefits reached $9,096,000 in 1969, an increase of 21% over the prior year.

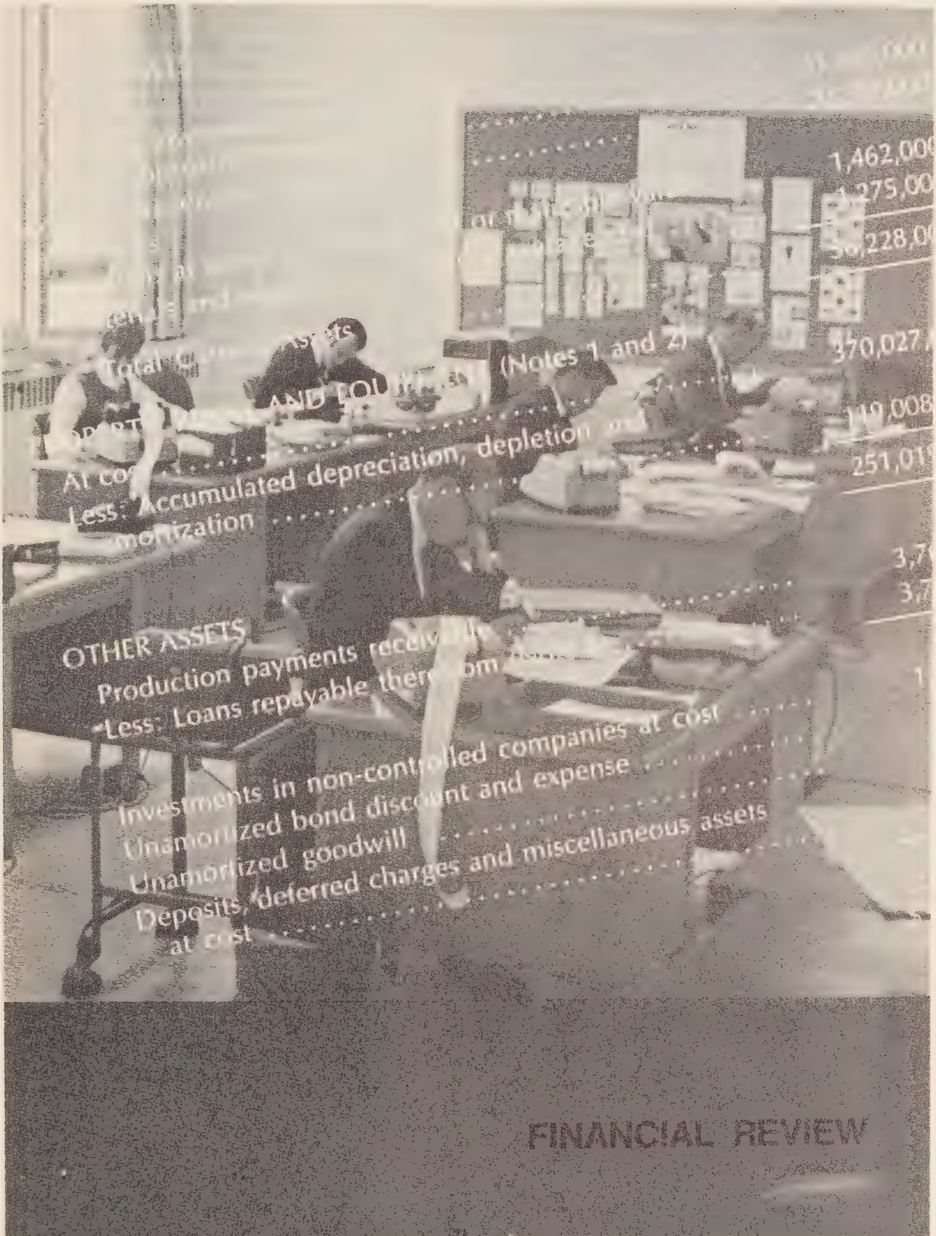
To assist in meeting its continuing requirements for competent professional and technical staff, the Company again recruited at many of the major universities across Canada and at several technical schools. The Company sponsored training programs, both on the job and through facilities available at educational institutions, to further develop the technical and managerial skills of its employees.

Through its Financial Aid to Education Program, the Company contributed a total of $87,000 in grants and scholarships to universities and technical schools and in payments to employees of 75% of the costs of work-related courses successfully completed on their own time. More than 100 employees received payments under this program in 1969.

Additional attention was focused on the Company's safety programs in 1969, with particular emphasis on gas plant operations. This continuing emphasis on safe operating practices resulted in a further reduction in the frequency of disabling injuries and enabled the Company to maintain its position of having one of the lowest accident frequency records in the petroleum industry.

Most of the employees participate in the Company's Thrift Plan which is designed to encourage savings by having the Company make contributions in proportion to the amounts deposited by employees. At year end the assets of the Plan, which are held by a trustee, totalled $1,437,000 at cost value, and had a market value of $1,759,000. These assets included 4,816 preferred shares and 26,470 common shares of the Company's capital stock purchased on instructions of employees for their accounts.

The Retirement Plan for employees of the Company is fully funded and at year end the trustee held cash and securities under the Plan with a total market value of approximately $3,833,000. Approximately 51% of the Fund's assets were held in equity investments, 41% in medium and long term fixed-income obligations and 8% in cash and short term obligations.


Less: Accumulated depreciation, depletion
OTHER ASSETS
Investments in non-controlled companies at cost
Unamortized bond discount and expense
Unamortized goodwill
Deposits, deferred charges and miscellaneous assets
at cost
FINANCIAL REVIEW

FINANCIAL REVIEW

Net earnings in 1969 were $27,030,000, a 0.9% increase over the $26,790,000 earned in 1968. The 1969 results, however, are after providing for an estimated income tax liability of $2,360,000 whereas previously no provision had been required for income taxes, except for a very minor amount in a subsidiary company, because of the accumulated deductions for drilling and exploration expenditures carried forward from prior years. After deducting preferred dividends, the 1969 earnings amounted to $1.40 per common share as compared with $1.38 per share in 1968. Funds generated from operations, after providing for income taxes, totalled $44,794,000, a gain of 4.8% over the $42,751,000 generated in the previous year. After deducting preferred dividends, funds generated from operations amounted to $2.37 per common share in 1969 as compared with $2.25 per share in the previous year.

Dividends declared for the year totalled $10,647,000, the same amount as in 1968. Four regular quarterly dividends of 62½ cents per share – a total of $1,500,000 – were declared on the Series A preferred shares. The total dividend on the common shares, at $9,147,000, was unchanged but in 1969 was declared in two semi-annual payments of 25 cents per share as compared with a single annual dividend of 50 cents per share in 1968.

Gross operating revenues totalled $76,495,000 for the year, an increase of $9,611,000 or 14.4%. The accompanying table shows the major sources of operating revenues and changes from the prior year. The reasons for the changes have been discussed in the various operations sections of this report. Income from investments and other miscellaneous sources totalled $4,867,000, a gain of $980,000. Most of this increase was derived from a higher rate of earnings on a greater amount of temporarily invested funds and from larger gains on disposals of assets.

Total expenses for the year were $54,332,000, an increase of $10,351,000 or 23%. Operating expenses, at $26,961,000, were up $4,093,000. The major factors in the increase were an additional $1,099,000 of exploration expenses, essentially for geophysical programs, and a $2,354,000 increase in production expenses most of which was incurred for the operation of new gas plants. Charges for depletion, depreciation and amortization, at $15,256,000, were $2,325,000 higher with a larger provision for depletion arising from greater production volumes and additional depreciation resulting from the large new investment in gas plants. Amortization charges for undeveloped acreage increased as a result of the additional investment in acreage and an increase in the amortization rate which was occasioned by the change in composition of the Company's undeveloped acreage holdings. The Company employs the "taxes payable" basis of accounting for income taxes and, accordingly, made provision in 1969 for an estimated $2,360,000 of income taxes currently payable with respect to the year's operations. The contingent future liability for income taxes which would have been provided for in 1969 if the Company had followed the "deferred tax" accounting concept in respect of all timing differences between accounting income and taxable income, is set forth in Note 4 to the Financial Statements.

GROSS OPERATING REVENUES

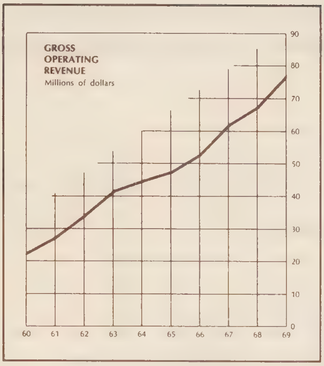
Category	Amount in 1969	Percentage of Total	Amount in 1968	Percentage of Total	Increase (Decrease) from 1968 Amount	Increase (Decrease) from 1968 Per Cent
Crude Oil	$36,580,000	47.8	$36,671,000	54.8	$ (91,000)	(0.2)
Natural Gas Liquids	10,593,000	13.8	6,490,000	9.7	4,103,000	63.2
Natural Gas	15,742,000	20.6	12,445,000	18.6	3,297,000	26.5
Sulphur	4,272,000	5.6	4,004,000	6.0	268,000	6.7
Processing Non-Owned Gas	2,659,000	3.5	1,381,000	2.1	1,278,000	92.5
Pipe Line & Product Distribution	6,649,000	8.7	5,893,000	8.8	756,000	12.8
Total	$76,495,000	100.0	$66,884,000	100.0	$9,611,000	14.4

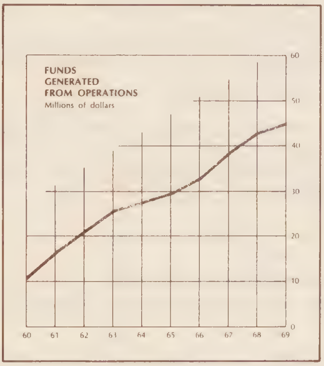
Capital expenditures for the year totalled $39,679,000, a reduction of $12,677,000 or 24% from the abnormally high level of 1968. Although $8,663,000 was spent for gas plants and related facilities in 1969, this was $17,765,000 less than the comparable outlays for such facilities in the prior year when five large gas plants were under construction. Expenditures for exploratory drilling and for pipe line and product distribution facilities also declined, by $1,272,000 and $1,809,000 respectively, but expenditures for acquisition of acreage were $8,405,000 greater than in 1968.

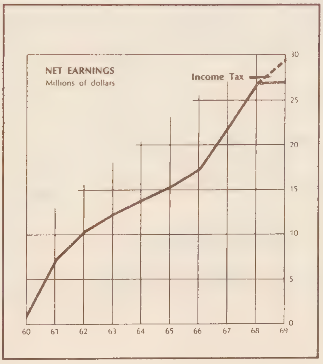
Proceeds from the disposal of properties and investments during the year totalled $2,389,000. The most significant item was the sale of the Company's minority interest in a silver producing company, Echo Bay Mines Ltd., for $1,000,000 cash.

The Company also obtained $5,175,000 in cash from partial prepayments for natural gas sales which it has contracted to deliver from the No. 2 and No. 3 plants at Kaybob South. The prepayments represent less than 10% of the total sales value of the contracted reserves and are to be applied in partial payment for the volumes delivered during the first ten years of the twenty year contract period. The prepayments have been set up on the Company's balance sheet as deferred credits and will be taken into revenues at the same rate as they are applied in payment of gas deliveries.

The amount of funds required in 1969 for capital expenditures, dividends, retirement of debt and other miscellaneous outlays exceeded the funds generated from operations and those obtained from disposals of properties and investments and from gas sales prepayments by $5,325,000. The Company entered the year with $16,510,000 of cash and short term investments and in the spring sold $25,000,000 of 7.85% Collateral Trust Bonds due 1994 payable in United States currency. The Collateral Trust Bonds are direct obligations of the Company secured by the pledge of an equal principal amount of a new series of its First Mortgage Bonds that rank equally with all other outstanding series of its First Mortgage Bonds. The sale of the Collateral Trust Bonds was underwritten by a large group of investment banking firms who offered them to the public in the United States at their par value. When converted to Canadian funds, the proceeds from the sale of this issue amounted to $26,909,000. The net result of these various transactions during the year was a $21,584,000 addition to working capital and the Company ended the year in a strong liquid position with $33,234,000 in cash and short term investments.







Hudson's Bay Oil and Gas Company Limited and Subsidiary Companies
CONSOLIDATED BALANCE SHEET—DECEMBER 31, 1969 AND 1968

ASSETS

	1969	1968
CURRENT ASSETS		
Cash	$ 1,374,000	$ 1,558,000
Short term investments at cost, which approximates market	31,860,000	14,952,000
Accounts receivable (Note 5)	20,257,000	18,862,000
Inventories		
Products at lower of average cost or realizable value	1,462,000	508,000
Materials and supplies at or below average cost	1,275,000	1,507,000
Total Current Assets	56,228,000	37,387,000
PROPERTY, PLANT AND EQUIPMENT (Notes 1 and 2)		
At cost	370,027,000	337,546,000
Less: Accumulated depreciation, depletion and amortization	119,008,000	105,718,000
	251,019,000	231,828,000
OTHER ASSETS		
Production payments receivable	3,761,000	9,866,000
Less: Loans repayable therefrom (Note 6)	3,761,000	9,866,000
	–	–
Investments in non-controlled companies at cost	1,793,000	1,937,000
Unamortized bond discount and expense	821,000	404,000
Unamortized goodwill	286,000	304,000
Deposits, deferred charges and miscellaneous assets at cost	3,360,000	2,467,000
	6,260,000	5,112,000
	$313,507,000	$274,327,000

Approved on behalf of the Board:

L. J. Richards, DIRECTOR

D. G. Jones, DIRECTOR

LIABILITIES AND SHAREHOLDERS' EQUITY

	1969	1968
CURRENT LIABILITIES		
Accounts payable and accrued liabilities (Note 5)	$ 19,226,000	$ 19,342,000
Dividends payable (Note 5)	4,949,000	9,522,000
Income and other taxes payable	2,407,000	269,000
Long term debt due within one year (Note 6)	4,238,000	4,430,000
Total Current Liabilities	30,820,000	33,563,000
LONG TERM DEBT (Note 6)	83,061,000	62,593,000
DEFERRED CREDITS		
Advances received on future natural gas sales	5,175,000	—
Other	1,540,000	1,643,000
	6,715,000	1,643,000
SHAREHOLDERS EQUITY		
Capital stock (Note 7)		
Authorized		
Preferred – $50 par value – 1,500,000 shares		
Common – $2.50 par value – 25,000,000 shares		
Issued and outstanding		
5% Cumulative redeemable convertible preferred shares series A – 600,000 shares	30,000,000	30,000,000
Common – 18,294,044 shares	45,735,000	45,735,000
Contributed surplus	21,095,000	21,095,000
Retained earnings	96,081,000	79,698,000
	192,911,000	176,528,000
	$313,507,000	$274,327,000

See accompanying notes

CONSOLIDATED STATEMENT OF EARNINGS

Years ended December 31, 1969 and 1968

	1969	1968
REVENUES		
Gross operating revenues	$ 76,495,000	$66,884,000
Investment and other income	4,867,000	3,887,000
	81,362,000	70,771,000
EXPENSES		
Exploration	9,438,000	8,339,000
Production	13,416,000	11,062,000
Pipe line and product distribution	2,119,000	1,839,000
General administrative	1,988,000	1,628,000
Depletion	5,305,000	4,814,000
Depreciation	7,498,000	6,353,000
Amortization of undeveloped oil and gas rights	2,453,000	1,764,000
Dry holes and abandonments	4,005,000	3,852,000
Interest (Note 6)	5,588,000	4,059,000
Other	162,000	251,000
	51,972,000	43,961,000
NET EARNINGS BEFORE INCOME TAXES	29,390,000	26,810,000
Income taxes (Note 4)	2,360,000	20,000
NET EARNINGS (Note 1)	$ 27,030,000	$26,790,000
NET EARNINGS PER COMMON SHARE (after preferred dividends)	$1.40	$1.38

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

Years ended December 31, 1969 and 1968

	1969	1968
Retained Earnings – January 1	$ 79,698,000	$63,555,000
Net Earnings	27,030,000	26,790,000
	106,728,000	90,345,000
Dividends Declared		
Preferred shares	1,500,000	1,500,000
Common shares	9,147,000	9,147,000
	10,647,000	10,647,000
Retained Earnings – December 31	$ 96,081,000	$79,698,000

See accompanying notes

CONSOLIDATED STATEMENT OF SOURCES AND USES OF FUNDS

Years ended December 31, 1969 and 1968

	1969	1968
SOURCES OF FUNDS		
Net earnings	$ 27,030,000	$ 26,790,000
Add non-cash items included in net earnings:		
Depreciation, depletion and amortization	15,256,000	12,931,000
Dry holes and abandonments	4,005,000	3,852,000
Other	(1,497,000)	(822,000)
Funds generated from operations	44,794,000	42,751,000
Sale of Collateral Trust Bonds	26,909,000	—
Sale of properties and investments	2,389,000	2,629,000
Advances received on future natural gas sales	5,175,000	—
TOTAL FUNDS AVAILABLE	$ 79,267,000	$ 45,380,000
USES OF FUNDS		
Expenditures for property, plant and equipment	$ 39,679,000	$ 52,356,000
Reduction of long term debt	6,441,000	7,150,000
Dividends declared	10,647,000	10,647,000
Miscellaneous – net	916,000	770,000
TOTAL FUNDS USED	$ 57,683,000	$ 70,923,000
RESULTING INCREASE (DECREASE)		
In cash and short term investments	$ 16,724,000	$(22,006,000)
In other working capital items	4,860,000	(3,537,000)
IN TOTAL WORKING CAPITAL	$ 21,584,000	$(25,543,000)

See accompanying notes

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Hudson's Bay Oil and Gas Company Limited and subsidiary companies as of December 31, 1969 and the consolidated statements of earnings, retained earnings and sources and uses of funds for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion, except that provision for taxes on income has not been made on the deferred tax basis in respect of depreciable assets as explained in Note (4), these consolidated financial statements present fairly the financial position of the Company and subsidiary companies at December 31, 1969 and the results of their operations and the sources and uses of their funds for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Peat, Marwick, Mitchell & Co.
Chartered Accountants

Calgary, Alberta
February 2, 1970

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(1) ACCOUNTING PRINCIPLES:

The consolidated financial statements include the accounts of Hudson's Bay Oil and Gas Company Limited and its subsidiary companies, each of which is wholly owned. The consolidated net earnings include the results of subsidiary companies from their respective dates of acquisition and where the purchase price of shares of subsidiaries exceeded their net book values the excess has been allocated to the assets acquired and additional depreciation, depletion and amortization has been provided accordingly. Where excess cost relates to the purchase of goodwill such goodwill is amortized over a ten year period.

Exploration expenses are charged against earnings as incurred.

Costs of oil and gas rights are capitalized when acquired. A regular charge is made to earnings for amortization of undeveloped oil and gas rights and when undeveloped rights are surrendered the cost is charged against the accumulated amortization. When rights are proven to be productive the original cost is transferred to the developed oil and gas rights account and written off by a depletion charge calculated on the unit of production method.

All costs of drilling wells are initially capitalized. If, on completion, a well is not capable of commercial production its cost is immediately written off. The costs of successful wells, other than equipment costs, are written off by depletion charges on the unit of production method in the same manner as the cost of developed oil and gas rights.

Plant, pipe line and equipment costs are depreciated on the straight line method at rates estimated to write off the costs over the useful lives of the assets, except that certain pipe line assets are depreciated on the unit of throughput method.

(2) PROPERTY, PLANT AND EQUIPMENT:

	Assets at Cost	Accumulated Depreciation	Accumulated Depletion	Accumulated Amortization	Net
Undeveloped oil and gas rights	$ 45,036,000	$ –	$ –	$5,655,000	$ 39,381,000
Developed oil and gas rights	32,864,000	–	11,130,000	–	21,734,000
Oil and gas rights on Hudson's Bay Company lands	1,000	–	–	–	1,000
Wells and related facilities	182,600,000	28,837,000	54,176,000	–	99,587,000
Plants and related facilities	73,166,000	10,863,000	–	–	62,303,000
Pipe line and product distribution facilities	33,741,000	7,210,000	–	–	26,531,000
Other	2,619,000	1,137,000	–	–	1,482,000
Total – December 31, 1969	$370,027,000	$48,047,000	$65,306,000	$5,655,000	$251,019,000
Total – December 31, 1968	$337,546,000	$41,859,000	$60,322,000	$3,537,000	$231,828,000

Pursuant to an agreement the Company has an exclusive right until December 31, 1999, to lease any or all of the petroleum and natural gas rights owned by Hudson's Bay Company. The exercise of this right requires no bonus payment. The Hudson's Bay Company lands subject to this agreement totalled 4,530,000 acres at December 31, 1969, primarily in the Provinces of Alberta, Saskatchewan and Manitoba. A nominal value of $1,000 has been assigned to these rights.

(3) REMUNERATION OF DIRECTORS:

Remuneration paid or payable by the Company and its subsidiaries to the Company's directors, including directors holding salaried employment as officers, totalled $165,000 in 1969. Remuneration to other senior officers totalled $185,000.

(4) INCOME TAXES:

In determining taxable income under the provisions of the Income Tax Act and Regulations, the Company and each of its subsidiaries is permitted to deduct currently: exploration expenses; the acquisition costs of petroleum and natural gas rights; the costs of drilling both successful and unsuccessful wells; and capital cost allowances greater than depreciation reported in their accounts. Any excess of such deductions over income may be carried forward and applied in subsequent years. After claiming maximum allowable deductions, the liability for income taxes for all companies is estimated to be $2,360,000, in respect to 1969 operations as compared with $20,000 in 1968.

If the Company had followed the deferred tax accounting concept in respect of all timing differences between accounting income and taxable income, provisions for deferred income taxes of $8,147,000 for 1969 and $9,389,000 for 1968 would have been required and the cumulative amount at December 31, 1969 would have been approximately $53,844,000. If the Company had provided deferred taxes solely on timing differences related to depreciable assets, deferred income taxes would have been provided in amounts of $4,272,000 in 1969 and $2,531,000 in 1968.

(5) AMOUNTS OWING TO AND FROM AFFILIATED COMPANIES:

Accounts receivable include $7,095,000 due from Continental Oil Company and its subsidiaries. Accounts payable include $344,000 due to Continental Oil Company and $64,000 due to Hudson's Bay Company. The fore-

going balances resulted from transactions in the normal course of business. Dividends payable include $3,006,000 due to Continental Oil Company and $1,002,000 due to Hudson's Bay Company.

(6) LONG TERM DEBT:

First Mortgage Sinking Fund Bonds	Due Within One Year	Long Term Portion
4% Series A, due May 1, 1975 – remaining sinking fund requirements $870,000 in 1971, $1,000,000 per annum – 1972 to 1974 and $10,000,000 at maturity	$ –	$13,870,000
5% Series B, due October 1, 1971 – remaining sinking fund requirements $50,000 per annum in 1970 and 1971	50,000	50,000
5¾% Series C, due August 1, 1977 – remaining sinking fund requirements $125,000 in 1971, $160,000 per annum 1972 to 1976 and $100,000 at maturity	–	1,025,000
5½% Series D, due June 15, 1983 – remaining sinking fund requirements $188,000 in 1970, $1,500,000 per annum 1971 to 1982 and $7,500,000 at maturity	188,000	25,500,000
7% Series E, due January 3, 1987 – remaining sinking fund requirements $207,000 in 1971, $500,000 in 1972 and $600,000 per annum 1973 to 1987	–	9,707,000
7.85% Series F, due April 15, 1994 (U.S. $25,000,000 issued and pledged to secure payment of the 7.85% Collateral Trust Bonds due 1994)	–	–
	238,000	50,152,000
Collateral Trust Bonds		
7.85% Collateral Trust Bonds due April 15, 1994 – sinking fund requirements U.S. $1,250,000 per annum 1979 to 1993 and U.S. $6,250,000 at maturity. (U.S. $25,000,000 recorded at exchange rate in effect at date of issue)	–	26,909,000
Term Loan		
Secured by assignment of hydrocarbon reserves. Interest at prime bank rate for production loans, principal repayable in ten quarterly installments of $1,000,000 each with final installment due April 1, 1972	4,000,000	6,000,000
Total – December 31, 1969	$4,238,000	$83,061,000
Total – December 31, 1968	$4,430,000	$62,593,000

On the foregoing long term debt the aggregate payments of principal required in each of the next five years are as follows: $4,238,000 in 1970; $6,752,000 in 1971; $5,160,000 in 1972; $3,260,000 in 1973 and $3,260,000 in 1974.

The loans of $3,761,000 recorded as a deduction from production payments receivable were incurred for the purposes of financing the cost of acquiring certain petroleum and natural gas rights which have been assigned as security for these loans. Since repayments of these loans and interest thereon is to be made exclusively from the proceeds of production from the assigned interests and the Company has no other obligation, the loans have been deducted from the production payments receivable.

Interest of $5,588,000 includes interest of $5,045,000 on long term debt described in the above table; interest of $524,000 on production loans described in the preceding paragraph; and other interest charges of $19,000.

(7) CAPITAL STOCK:

The Preferred Shares Series A are redeemable at the option of the Company from October 15, 1972 through October 14, 1977 at $53.50 and thereafter at $51.00. At the option of the holder each Preferred Share Series A may be converted into one and one-fifth Common Shares at any time on or before October 15, 1972 or thereafter may be converted into one Common Share on or before October 15, 1977 or such earlier date as may result from notice of redemption of the shares.

At December 31, 1969 there were 720,000 Common Shares reserved for issue upon exercise of the rights of conversion attaching to the Preferred Shares Series A, being the maximum number of Common Shares that would be issued if all the Preferred Shares Series A were converted during the first conversion period.

(8) COMMITMENTS AND CONTINGENT LIABILITIES:

At December 31, 1969 the Company had long term lease agreements for office space under which the net rentals payable in 1970 will be $327,000, including $296,000 payable for the Calgary office building.

The Company and its subsidiaries have issued to and deposited with governmental authorities an aggregate of $929,000 of non-interest bearing demand notes to be held as security for the performance of work obligations in respect of certain exploratory rights.

The Company has a contingent liability to purchase up to $2,258,000 of bonds of a pipe line company in which it has a share ownership. In addition, the Company has guaranteed the payment of principal (amounting to $2,974,000 at December 31, 1969) and interest on certain outstanding debentures of the same pipe line company.

Hudson's Bay Oil and Gas Company Limited

Incorporated under the Laws of Canada

BOARD OF DIRECTORS

A. W. TARKINGTON, *Chairman, New York, Vice-Chairman of the Board of Directors of Continental Oil Company*

J. R. MURRAY, *Vice-Chairman, Winnipeg, Managing Director of Hudson's Bay Company*

T. N. BEAUPRÉ, *Montreal, Chairman of the Board of Directors of Domtar Limited, and a Director of Hudson's Bay Company*

W. E. GLENN, *Houston, President of Western Hemisphere Petroleum Division and a Director of Continental Oil Company*

D. C. JONES, *Calgary, Executive Vice-President of the Company*

D. E. KILGOUR, *Winnipeg, President and a Director of The Great-West Life Assurance Company, and a Director of Hudson's Bay Company*

HERBERT H. LANK, *Montreal, Director of DuPont of Canada Limited*

J. G. MCLEAN, *New York, President and Chief Executive Officer and a Director of Continental Oil Company*

L. J. RICHARDS, *Calgary, President of the Company*

J. S. ROYDS, *New York, Senior Vice-President and a Director of Continental Oil Company*

OFFICERS

L. J. RICHARDS, *President*

D. C. JONES, *Executive Vice-President*

K. H. BURGIS, *Financial Vice-President*

R. J. HAMILTON, *Vice-President, Exploration*

S. G. OLSON, *Vice-President, Production*

R. F. HASKAYNE, *Controller*

F. J. MAIR, *Treasurer*

W. E. SELBY, *Secretary*

TEN YEAR OPERATING REVIEW

	1969	1968	1967	1966	1965	1964	1963	1962	1961	1960
LIQUID HYDROCARBONS PRODUCTION - NET (Barrels per day)										
Crude Oil - Alberta	31,832	31,804	29,386	25,856	25,456	26,389	25,057	22,167	22,521	19,525
British Columbia	6,100	5,710	5,693	5,247	3,083	2,220	2,216	1,354	178	10
Saskatchewan	4,527	4,919	5,259	4,826	4,582	4,294	3,799	3,265	2,668	2,386
Manitoba	19	19	16	14	13	10	10	4	5	8
TOTAL CRUDE OIL	42,478	42,452	40,354	35,943	33,134	32,913	31,082	26,790	25,372	21,929
Natural Gas Liquids - Condensate	10,058	6,091	6,282	5,944	5,303	4,877	4,373	3,349	1,311	694
LPG	1,890	972	658	569	453	346	231	215	139	66
TOTAL NATURAL GAS LIQUIDS	11,948	7,063	6,940	6,513	5,756	5,223	4,604	3,564	1,450	760
TOTAL CRUDE OIL AND NATURAL GAS LIQUIDS	54,426	49,515	47,294	42,456	38,890	38,136	35,686	30,354	26,822	22,689
NATURAL GAS SALES - NET (Millions of cubic feet per day)	281.7	233.3	196.7	169.5	138.2	116.6	104.6	82.1	60.1	43.6
SULPHUR (Net long tons per day) - Production	955	500	481	404	344	246	238	140	11	2
Sales	760	406	433	386	343	245	237	132	5	–
PIPE LINE										
Throughput (Barrels per day)	70,135	66,578	58,812	56,123	57,502	58,817	53,724	42,678	30,759	23,597
Miles of Trunk Line	420	420	420	391	200	200	200	187	117	78
Miles of Gathering Facilities	425	423	366	334	314	297	266	211	166	114
WELL DATA										
NET DEVELOPMENT WELLS COMPLETED										
Oil	31.5	19.3	30.0	34.8	38.4	60.2	66.3	65.1	52.7	47.9
Gas	19.8	16.2	17.1	9.8	10.3	8.0	8.7	7.1	2.7	7.1
Dry	6.7	6.9	8.8	12.1	11.0	9.8	14.9	13.8	5.2	4.8
TOTAL	58.0	42.4	55.9	56.7	59.7	78.0	89.9	86.0	60.6	59.8
NET EXPLORATORY WELLS COMPLETED										
Oil	4.0	4.8	19.9	9.5	7.2	5.0	5.4	2.8	3.5	3.0
Gas	4.9	3.9	8.0	9.0	4.2	7.7	8.1	2.3	5.2	4.0
Dry	43.1	29.5	33.3	40.0	28.9	28.9	22.1	16.8	9.6	14.3
TOTAL	52.0	38.2	61.2	58.5	40.3	41.6	35.6	21.9	18.3	21.3
TOTAL GROSS WELLS COMPLETED	244	166	203	222	195	225	249	164	126	140
NET WELLS CAPABLE OF PRODUCTION										
Oil Wells	1,010.3	978.7	992.2	957.1	919.7	917.2	877.0	754.6	698.6	646.6
Gas Wells	226.5	201.1	189.7	166.8	152.7	136.2	125.3	97.4	88.0	80.0
TOTAL	1,236.8	1,179.8	1,181.9	1,123.9	1,072.4	1,053.4	1,002.3	852.0	786.6	726.6
OIL AND GAS RIGHTS - NET (Thousands of acres)										
Undeveloped										
Alberta	4,005	4,610	5,520	6,434	6,699	5,745	5,601	4,367	4,267	3,986
Saskatchewan	4,742	4,751	4,996	5,196	3,931	2,960	2,980	2,655	2,584	2,628
British Columbia	2,391	1,078	980	1,025	1,203	1,161	1,952	2,000	2,379	4,102
Northwest Territories (Including Arctic Islands)	5,197	3,571	2,293	2,033	1,871	1,027	1,461	1,697	1,717	2,012
Maritimes	5,195	5,405	4,583	9,167	9,167	–	–	–	–	–
Manitoba	789	789	789	789	789	792	792	703	703	703
TOTAL UNDEVELOPED	22,319	20,204	19,161	24,644	23,660	11,685	12,786	11,422	11,650	13,431
Developed	512	472	405	383	356	347	321	274	242	164
TOTAL	22,831	20,676	19,566	25,027	24,016	12,032	13,107	11,696	11,892	13,595

TEN YEAR FINANCIAL REVIEW (1)

		1969	1968	1967	1966	1965	1964	1963	1962	1961	1960
GROSS OPERATING REVENUES											
Crude Oil	$	36,580	36,671	34,848	31,358	28,867	28,879	27,112	22,987	20,887	17,720
Natural Gas Liquids	$	10,593	6,490	6,314	5,826	5,196	4,709	4,312	3,234	1,097	588
Natural Gas	$	15,742	12,445	10,483	9,009	7,339	5,954	5,218	3,895	2,478	1,741
Sulphur	$	4,272	4,004	3,641	1,527	1,428	430	411	241	30	–
Processing Non-owned Gas	$	2,659	1,381	1,389	1,197	820	593	666	414	211	131
Pipe Line and Product Distribution	$	6,649	5,893	5,013	3,565	3,567	3,677	3,305	2,825	2,236	1,841
TOTAL	$	76,495	66,884	61,688	52,482	47,217	44,242	41,024	33,596	26,939	22,021
EARNINGS AND DIVIDENDS											
Net Earnings (2)											
Before Income Taxes	$	29,390	26,810 }	22,139	17,371	15,355	13,803	12,331	10,166	7,006	1,004
After Income Taxes	$	27,030	26,790 }								
Per Common Share (after preferred dividends)	$	1.40	1.38	1.19	.95	.84	.75	.67	.57	.39	.06
Funds Generated from Operations											
Total (after income taxes)	$	44,794	42,751	38,277	32,813	29,444	27,372	25,760	21,106	16,440	11,089
Per Common Share (after income taxes and preferred dividends)	$	2.37	2.25	2.07	1.79	1.61	1.50	1.41	1.19	.93	.62
TOTAL DIVIDENDS DECLARED	$	10,647	10,647	9,522	7,318	7,318	6,403	5,488	5,324	3,549	–
Per Common Share	$	.50	.50	.50	.40	.40	.35	.30	.30	.20	–
Per Preferred Share	$	2.50	2.50	.625	–	–	–	–	–	–	–
CAPITALIZATION											
Long-Term Debt (including portion due within one year)	$	87,299	67,023	73,843	68,753	55,560	51,210	52,858	23,589	25,278	26,500
Shareholders' Equity	$	192,911	176,528	160,385	118,300	108,247	100,210	92,810	77,479	71,781	68,324
TOTAL CAPITAL EMPLOYED	$	280,210	243,551	234,228	187,053	163,807	151,420	145,668	101,068	97,059	94,824
Shareholders' Equity as % of Total Capital Employed		68.8%	72.5%	68.5%	63.2%	66.1%	66.2%	63.7%	76.7%	74.0%	72.1%
Number of Preferred Shares Outstanding		600,000	600,000	600,000	–	–	–	–	–	–	–
Number of Common Shares Outstanding		18,294,044	18,294,044	18,294,044	18,294,044	18,294,044	18,294,044	18,294,044	17,744,592	17,744,592	17,744,592
CAPITAL EXPENDITURES AND EXPLORATION EXPENSES											
Exploration Expenses											
Geological, Geophysical and Other Exploration Expenses	$	6,955	5,767	5,156	3,319	2,720	2,570	2,269	2,535	1,841	2,251
Lease Rentals	$	2,483	2,572	2,280	2,857	2,908	2,224	2,191	2,027	2,032	2,169
Acquisition of Oil and Gas Rights	$	14,171	5,766	1,493	3,775	7,847	3,037	28,534	4,320	2,138	3,344
Exploratory Drilling	$	4,031	5,303	8,053	5,873	4,535	4,191	4,663	3,224	2,105	2,791
Development Drilling and Production Facilities	$	10,893	10,622	13,100	8,891	7,618	10,433	12,396	8,287	7,704	9,424
Plants and Related Facilities	$	8,663	26,428	6,049	4,788	5,861	5,350	2,812	1,899	6,849	1,175
Pipe Line and Product Distribution Facilities	$	1,496	3,305	5,085	8,536	847	812	2,341	3,315	2,426	242
Other	$	425	932	536	354	362	358	161	245	131	307
TOTAL CAPITAL AND EXPLORATION EXPENDITURES	$	49,117	60,695	41,752	38,393	32,698	28,975	55,367(3)	25,852	25,226	21,703
EMPLOYEES AND SHAREHOLDERS											
Number of Preferred Shareholders		2,677	2,851	3,312	–	–	–	–	–	–	–
Number of Common Shareholders		8,688	8,864	9,254	9,859	10,674	11,548	12,526	11,038	11,485	11,956
Number of Employees		938	849	738	613	574	506	475	454	425	407

(1) With the exception of per share figures, dollar amounts are in thousands.
(2) Exclusive of special credits of $856,000 in 1962 and $265,000 in 1960.
(3) Includes $27,866,000 acquisition costs of Consolidated Mic Mac Oils Ltd. and Security Freehold Petroleums Limited.

HEAD OFFICE

320 Seventh Avenue South West, Calgary 2, Alberta

SUBSIDIARY COMPANIES (all wholly-owned)

AURORA PIPE LINE COMPANY, incorporated by Special Act of the Parliament of Canada

BLUE FLAME PROPANE LTD., incorporated under the Laws of the Province of Alberta

HBOG MINING LIMITED, incorporated under the Laws of the Province of Ontario

MIC MAC OILS (1963) LTD., incorporated under the Laws of the Province of Alberta

RANGELAND PIPE LINE COMPANY LIMITED, incorporated under the Laws of the Province of Alberta

SECURITY FREEHOLD PETROLEUMS LIMITED, incorporated under the Laws of Canada

TRANSFER AGENTS

Common Shares

MONTREAL TRUST COMPANY, Calgary, Montreal, Toronto, Vancouver and Winnipeg

MORGAN GUARANTY TRUST COMPANY OF NEW YORK, New York

Preferred Shares

MONTREAL TRUST COMPANY, Calgary, Montreal, Toronto, Vancouver and Winnipeg

STOCK EXCHANGE LISTING

Common and Preferred Shares

TORONTO STOCK EXCHANGE

AUDITORS

PEAT, MARWICK, MITCHELL & CO., Calgary

APPENDIX "B"

NAME: HUDSON'S BAY OIL AND GAS COMPANY LIMITED

SUBJECT: White Paper Proposals

Analysis of Appendix "A" by Senior Advisor

The Brief is submitted by Hudson's Bay Oil and Gas Company Limited, a company incorporated in 1926 by Continental Oil Company of the United States and The Hudson's Bay Company of England. The company did not undertake large scale exploration and development work until about 1947. In 1957 the company issued shares of its capital stock to the public. On December 31, 1969 ownership of the capital stock of the company was held, 65.7% by Continental, 21.9% by Hudson's Bay and 12.4% by the public.

The Brief's comments and recommendations are divided into the following sections:

(1) Proposals concerning the petroleum industry.

(2) Taxation of capital gains

(3) Corporations and their shareholders.

(4) Economic effect of the White Paper.

(5) Effects of the White Paper on financing.

(6) Other proposals for changes in taxation.

The authors of the Brief have adopted the policy of reproducing on the left hand page the relavent section of the White Paper and marking their comments on the right hand page, accordingly it has not been necessary to make the usual summary.

The attention of the Committee is drawn to the following comments:

(1) "Without the tax incentives which were available to attract the initial high risk foreign capital and stimulate continued exploration activities, the Company would not have been able to develop to its present position." (Pages 1 and 2 of Exhibit 1 of the Brief).

(2) "HBOG appreciates the objectives of the White Paper proposals and agrees generally with the aims expressed

in paragraph 1.6 which appear to be reasonable and logical. However, the measures suggested to achieve these aims are new, far reaching and untested and we are concerned with their potential adverse repercussions." (Page 2 of the Brief).

(3) "We believe that most of the objectives can be achieved with minor changes to Canada's existing tax system and others by a gradual implementation of new ideas. Limitation of Government expenditures to fit reasonable revenue expectations should be an objective rather than to tailor a tax system to meet spiralling expenditures." (Page 2 of the Brief).

(4) "HBOG agrees that greater equity in taxation will be achieved by including capital gains in the tax base. We do not, however, believe that all income should be taxed on the same basis; recognition should be given to the risks involved and the contribution to the country's economic growth." (Page 11 of the Brief).

(5) "The White Paper's definitions of widely and closely held corporations are based on broad generalizations which do not fit many Canadian companies." (Page 16 of the Brief).

Proposals concerning the Petroleum Industry
(Pages 4 to 10 of the Brief)

(1) Production depletion (Page 5 to 8 of the Brief). The Brief points out that the proposal to earn depletion at the rate of $1 for every $3 spent is a poor substitute for the present unrestricted depletion incentive. Particularly as the investment for finding and developing present reserves was evaluated and made on the basis of present legislation. Costs of mineral rights is as much a cost of exploration as is the seismic or drilling service and should earn depletion.

(2) Royalty depletion (Pages 8 and 9 of the Brief). The Brief points out that there is no significant distinction between royalty and working interest income to operators, as both are common methods of sharing production.

(3) Loss of depletion incentive to shareholders. (Pages 9 and 10 of the Brief).

The Brief points out that the effects of integration are to take away 75% of the depletion incentive in the case of widely held corporations and 100% in the case of closely held corporations.

(4) Sale of Mineral Rights (Page 10 of the Brief).

The Brief comments upon the present requirements of the Income Tax Act which require income subject to depletion to be reduced by the cost of mineral rights acquired yet taxes in full proceeds received from the sale of such rights.

Taxation of capital Gains (Pages 11 to 15 of the Brief).

The Brief points out:

(1) There is sufficient distinction between a capital gain and an income receipt that the proposal to tax both at full marginal rates is unreasonable.

(2) The proposed averaging provisions are entirely inadequate to provide relief from the punitive effects of taxing capital gains at full marginal rates and are completely ineffectual for tax payers with annual taxable incomes of $18,000 or more.

(3) The proposed five year revaluation is unduly harsh.

(4) The taxation of deemed realizations would cause major shareholders to lose control of their corporation, through forced sale of shares to pay their tax.

(5) The taxation of gains on sale of principal residences and the disallowance of any loss does not appear equitable.

Corporations and their Shareholders (Page 16 to 20 of the Brief)

The Brief points out that it opposes the integration system as it is impractical and may produce undesirable results for the following reasons:

(1) The proposals favour the mature corporations and prejudice the growth companies.

(2) "Low taxpaying" corporations will be less attractive to the Canadian investor and therefore more attractive to non resident investors.

(3) The possibility of artificial manoeuvres designed to credit the maximum corporate tax to Canadian shareholders.

(4) The proposals are relatively complicated and will involve much additional record keeping by the Government and by both corporate and individual tax payers.

(5) The substantial time lag between the issue of a T-5 form showing dividend income paid to shareholders and the completion and assessment of the corporations' income tax return.

Economic Impact of the White Paper (Pages 21 to 23 of the Brief).

"HBOG agrees with the Government that changes in the tax system to block loopholes and to provide a fair distribution of the tax burden are desirable goals. We also share the Government's concern with the financial hardship of many Canadians on the lower end of the income scale. However, we feel that the proposals of the White Paper are so wide-ranging and complex that to implement them in toto would result in a serious disruption of the Canadian economy."

Effects of the White Paper on Financing (Pages 24 to 26 of the Brief).

"In the past HBOG has endeavoured to expand its Canadian equity ownership and will continue its efforts to do so in the future. We are concerned that the Canadian capital market will not be receptive to purchasing equity securities in a resource based company. The combination of inflation, high interest rates and a bias against the high risk petroleum industry would create very real financing problems even for a strong, emerging company such as HBOG."

Other Proposals for Changes in Taxation (Pages 27 to 31 of the Brief).

The Brief lists a number of items which it suggests should be included as "nothings" and allowable as deductions. These are:

(1) Payments for rights-of-way for pipe lines.

(2) Commissions and other costs pertaining to share and debt issues.

(3) Bond discount.

(4) Trade marks and corporate symbols.

(5) Mineral rights acquired prior to April 11, 1962.

(6) Line-fill in pipe lines.

The Brief also submits that reasonable expenses for entertainment, costs of conferences or conventions and dues for certain clubs are legitimate business costs.

The Brief makes a number of recommendations, these are:

(1) "Depletion should be calculated at 20% of gross production income limited to 33 1/3% of exploration and development expenditures, including the cost of mineral rights. Developed properties held on November 7, 1969 should logically be exempt from the earning provisions." (Page 8 and Page 33 of the Brief).

(2) Tax capital gains at lower rates than ordinary income, with a maximum rate of 25%. (Page 12 and Page 33 of the Brief).

(3) The proposal to tax deemed realization of capital gains on widely-held corporations should be eliminated. (Page 14 and 15 of the Brief).

(4) That any "capital gain" made on a taxpayer's principal residence be exempt completely from taxation. (Page 15 of the Brief).

(5) That all corporations and their shareholders be taxed in a similar equitable manner with respect to dividends received and profits made on the sale of shares. (Pages 16 and 17 of the Brief).

(6) Modification of the present tax credit system to accomplish the same results as the integration proposals. (Page 34 of the Brief).

(7) Any substantial tax reforms should provide for gradual implementation to avoid serious disruption of the Canadian economy. (Page 34 of the Brief).

(8) Elimination of many of the minor proposals which would produce small amounts of revenue but which would require substantial administrative costs to the Government and unrealistic record keeping by the taxpayer. (Page 34 of the Brief).

APPENDIX "C"

BRIEF

TO

THE SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

AQUITAINE COMPANY OF CANADA LTD.

May 14, 1970

INTRODUCTION

* * * * * * *

AQUITAINE COMPANY OF CANADA LTD. - SOCIETE AQUITAINE DU CANADA LTEE (the "Company") was incorporated on December 30, 1963, by letters patent issued under the federal laws of Canada. The Company's head office is located in Calgary, Alberta. The Company is a partially owned subsidiary of Société Nationale des Pétroles d'Aquitaine (SNPA), which owns 82.4% of the outstanding common shares of the Company. The remaining outstanding common shares of the Company are in the hands of the public as a result of two public issues, the first in November, 1968, through Canadian underwriters and the second in June, 1969, through both Canadian and United States underwriters. The common shares of the Company are listed on the Montreal, Toronto and American Stock Exchanges and as a result thereof, the Company will qualify as a widely held Canadian corporation (WHC) within the meaning

of Paragraph 4.43 of the White Paper.

SNPA is a French oil company, having its head office just outside of Paris, France. 51% of the capital stock of SNPA is held by a state agency of France, Entreprise de Recherches et d'Activités Petrolières. The remainder of the capital stock of SNPA is held by more than 200,000 shareholders, the majority of whom reside in France. SNPA's shares are traded on the Paris and Brussels Stock Exchanges.

The Company is currently engaged in oil and gas exploration and production in Canada directly or through its partially owned subsidiary, Banff Oil Ltd. In conjunction with Banff Oil Ltd., the Company carried out an exploration program in Northern Alberta which led to the discovery in March, 1965 of a major oil field at Rainbow Lake. The Rainbow area is now one of the principal producing areas in Canada and the Company's holdings in this area represent its primary producing asset.

While the Company has serious reservations as to a substantial number of aspects of the White Paper on tax reform beyond those presented in this brief, it proposes to limit itself to a number of problems which are particularly applicable to its status as a WHC controlled by a non-resident parent company. In particular, this brief will deal with (a) the application of the capital gains tax to SNPA should it sell any of its common shares of the Company (Paragraph 6.47), (b) the application of the five-year revaluation rule to the common shares of the Company held by SNPA (Paragraphs 3.33 and 6.47), and (c) the taxing of unrealized capital gains when taxpayers leave Canada (Paragraph 3.40). In addition, the Company will refer to the proposed method of taxing dividends under the White Paper, with particular reference to the procedures set forth in the White Paper as applicable to non-resident shareholders. (Paragraphs 4.49 and 4.50).

The Application of the Capital Gains Tax to Non-Residents

The Company strongly objects to the provisions of the last sentence of Paragraph 6.47, which would impose a capital gains tax upon its parent shareholder, SNPA, should it at any time or from time to time sell the whole or any part of its common shares of the Company.

The proposal to tax capital gains of non-resident shareholders, even where, in the case of WHC, limited to non-residents who are selling shares out of substantial interest, is inconsistent with generally accepted international tax principles and practices. To our knowledge, West Germany and the Netherlands are the only major western countries which attempt to levy a similar tax, and the experience of these two countries has apparently not been a happy one in this area.

Neither the United States nor the United Kingdom imposes capital gains tax on foreign shareholders as such and it appears to the Company that Canada's position in the international investing community would not be improved by the imposition of such a taxing system. It might be noted, moreover, that the Organization for Economic Co-operation and Development Model Treaty which has been accepted by Canada (with reservations which do not affect this matter) appears to prohibit the country of incorporation from taxing capital gains of non-resident shareholders who have no other connection with the country of incorporation. It is difficult to conceive, therefore, why at this juncture, and in the face of ever increasing world pressure to eliminate this and equivalent types of taxes on foreigners, Canada should choose to attempt to impose such an unfair treatment on foreign shareholders.

The proposed tax of Paragraph 6.47 of the White Paper (and for that matter Paragraph 6.46 with reference to closely held Canadian corporations (CHC)) discriminates seriously against foreign shareholders of Canadian companies as compared to their Canadian counterparts. The impact of the

proposed capital gains tax on Canadian shareholders can, in many instances, be reduced by dividends in cash or stock carrying with them substantial tax credits, so that at least theoretically, the proposed capital gains tax could be considerably minimized. Since, however, the proposed dividend credits of the White Paper are not to apply to non-resident shareholders (Paragraphs 4.49 and 4.50), and in addition withholding tax on dividends to non-residents is to continue to be applied, foreign shareholders of Canadian companies will not only be unable to use the same relief procedures for capital gains as are given to Canadian shareholders, but in addition, may be taxed in their country of residence or domicile on such distributed receipts without equivalent off-setting tax credits. Moreover, although the Company cannot in the absence of specific statutory provisions analyse the result in detail, it seems quite possible that under the various taxing procedures of Canada and France the proposed Canadian capital gains tax on any profits which may be made by SNPA on the Company's shares would not be available as

a tax credit under the French law against any capital gains tax thereon which might be levied by France, except possibly to the extent of 10% if technically Canada defines these gains as commercial and industrial profits. The proposed procedure would also cause serious prejudices to foreign shareholders who had losses on actual or deemed dispositions of their assets in Canada or abroad, but would not be allowed to use them as deductions in computing the proposed capital gains tax of the White Paper.

Finally, even if it is accepted that such a tax might be imposed, the Company submits that the problems of collection and tax avoidance will be so difficult that the vast majority of transactions which should be subjected to tax will not be, in fact, collected or collectible by Canada. If the provisions of Paragraph 6.47 result in legislation, it is clear that it will give rise to a substantial growth in the use of bearer shares, unrecorded transfers and other easily available means of eliminating the impact of the tax, which elimination will be virtually impossible for Canada to cure, since it will have been effected by individuals or corporations over which Canada has no jurisdiction, domestically or internationally. The incidence of such unquestionable wide-

spread tax avoidance will bear particularly hard on those foreign investors who feel that they must abide by the law of Canada, notwithstanding their disagreement with the philosophy of its imposition and, in the long run, will lead to the decision of such types of foreign investors to avoid the investment rather than subject themselves to the potential tax.

2. The Five-Year Revaluation Rule

While it is not clear as to whether or not the five-year revaluation rule of Paragraph 3.33 does apply to companies such as SNPA, most of the commentary on the White Paper would seem to imply that such is the case. Had the five-year revaluation rule been applicable on, let us say, the difference between the excess of the investment of SNPA in the Company and the value thereof on the day the White Paper was enacted, the result (assuming a net 25% tax) would have been to impose a very large tax on SNPA. Since, under the French law, in no way would such tax on unrealized gains have been available as a credit against French tax, the

Canadian tax would have been on a gross basis on SNPA. If, therefore, at some subsequent date SNPA should sell the whole or any part of its common shares of the Company and be at such time subjected to a French tax on the gain, the previous Canadian tax paid on the deemed realization would be a complete and clear double taxation on SNPA with respect to its investment in the shares of the Company. Depending on the time of deemed and realized appreciation, it is, therefore, conceivable that the aggregate of the taxes imposed by both Canada and France might exceed the profit ultimately realized by SNPA, a situation which, of course, runs counter to every concept of the fairness of an imposition of taxes in the international community.

The Company must, therefore„ urgently request that any doubts as to the non-applicability of the five-year re-valuation rule to non-resident shareholders be eliminated. It does, however, stress this point only as an ancillary recommendation to its primary request that both realized and unrealized gains of non-residents not be taxed, except possibly,

if and to the extent such gains are realized in Canada as a result of a business carried on in Canada by a non-resident through a permanent establishment.

3. Taxing Unrealized Capital Gains When Taxpayers Leave Canada

Paragraph 3.40 would tax all unrealized gains when a resident moves abroad. This seems fair on the surface but it is questionable whether it will really work fairly and usefully in practice.

Mobility of Canadian and foreign personnel is necessary in order to conduct international operations from foreign bases or from Canadian headquarters. If all unrealized gains are to be taxed whenever a person moves from Canada this will substantially impede the transfer of Canadians abroad or temporary assignments of foreigners to Canada. This impediment will be particularly onerous in the case of French individuals, since France does not impose a capital gains tax on individuals.

In order to avoid such a "freezing" of personnel,

the Company proposes that such tax be eliminated or at the very least capital gains taxes not be imposed after short term periods of residence in Canada or if long term Canadian residents intend to become foreign residents for a limited time. It is appreciated that the latter case may present problems because it may be difficult to determine when a resident leaves, how long he will in fact stay away. Adequate safeguards could, however, probably be taken to ensure payment of capital gains tax if such person remained abroad for more than a limited time.

A significant problem with imposition of capital gains tax on changes of residence is enforcement. Effective policing would require an extensive system of exit controls which would be almost impossible to implement on our borders. Short of isolating our country with iron curtain type restrictions, collection of the tax will largely depend on voluntary cooperation, and this may often be lacking if a person is moving abroad.

In view of this, there seems to be every good reason why Canada should not impose such a tax. The Company urges

this result or at least that the tax be limited to those instances where permanent and long term changes in residence are involved.

4. Corporate Distributions

The Company does not propose to deal at any length with the proposals of the White Paper on corporate distributions, except to note specifically the philosophy contained in Paragraphs 4.49 and 4.50, with which the Company disagrees. The law of France through the use of the préconte and avoir fiscal procedure imposes a system of taxing corporate distributions somewhat similar to that envisaged by the White Paper. In its original application, France took the same position as the White Paper that the privileges of the grossing up procedure and credit for corporate taxes paid should not be extended to foreign shareholders of French corporations. This decision by France met with almost universal condemnation, to the effect that, first in the case of West Germany and then in the case of the

United States, France has given up its decision not to extend to foreign shareholders the credit for corporate taxes paid. The result of the French action, necessitated by the West German and United States objections, has been that France will not merely cancel all withholding tax on dividends from French companies to residents of these countries but will in addition, subsidize the governments of these countries by paying them an amount equal to the tax loss to these countries where they give their respective shareholders tax credit for the taxes paid to France.

In the opinion of the Company, therefore, the reasoning of Paragraphs 4.49 and 4.50 of the White Paper does not accord with the facts of life in the international taxing community and it might be optimistic for Canada to assume that the international taxing community will not insist that Canada accord with the generally accepted rules when various tax conventions are being negotiated. Moreover, in fact, if not absolutely technically, the reasoning of Paragraph 4.49 is incorrect. Thus, while the last sentence of Paragraph 4.49

might conceivably be right if all countries of the world were taken on a per country basis, it certainly does not apply to the major investor in Canada, namely the United States, where under the Internal Revenue Code of the United States, a company having more than a ten per cent interest in a Canadian company may take a tax credit for an appropriate portion of the Canadian and provincial corporate income taxes paid by the Canadian corporation.

It seems to the Company, therefore, that a continuation of the existing system of taxing corporate dividends would be far more satisfactory than a plunge into the virtually unknown procedures contemplated by the White Paper, particularly if the assumptions of success are based on the types of misapprehension such as those reflected in Paragraphs 4.49 and 4.50.

SUMMARY

For the reasons set forth above, the Company on its own behalf and on behalf of SNPA submits that the proposed tax on both realized and unrealized gains of non-resident

shareholders of both closely held and widely held Canadian corporations be eliminated. In a world economy competing for capital investment, no one country can afford to contravene the generally accepted norms of taxation practised by the international community. In the case of Canada, which is so intimately linked with the United States in both business and investment, the availability of equivalent investment in the United States is much too evident to permit the scales to be tipped so favourably in their direction. The Company is uniquely aware of the feelings of one major foreign investor, its own parent company, on the proposed capital gains tax of its shares in the Company, and as a Canadian company it would deeply regret the creation of a system which would change the ground rules under which SNPA continues its expanding effort in this country. The Company also respectfully submits that the assumption of the White Paper that tax treaties between Canada and the various countries will be easily renegotiated is not correct. In the case of France, in both the areas of dividend credits and capital gains, it will certainly be very difficult if not impossible.

The Company, therefore, recommends:

a) that Paragraphs 6.43 to 6.47 of the White Paper be eliminated and that the general international rule of law be retained that the realized and unrealized profits of non-residents on shares of Canadian companies, or for that matter any other assets in Canada other than business assets located in Canada, be excluded from the capital gains provisions of the proposed law (The Company is aware of the so-called "loophole" arguments of Paragraphs 6.45 and 6.46, but it is certain that there must be other methods to close these loopholes without, at the same time, imposing this most onerous system of taxation);

b) that the proposed tax upon unrealized capital gains when taxpayers leave Canada be eliminated, or at the least substantially modified to permit free interchange of personnel; and

c) that a close re-examination be made of the proposals of the White Paper for taxing

corporate distributions and, in particular, the application thereof to non-resident shareholders, since the Company believes that the assumptions and philosophy of the White Paper are incorrect and will not accord with the position taken by other countries with whom Canada has relations.

* * * * * * *

APPENDIX "D"

NAME: AQUITAINE COMPANY OF CANADA LTD.

SUBJECT: Widely Held Corporation Controlled By a Non-Resident Parent Company.

Analysis of Appendix "C" by Senior Advisor.

This Brief is submitted by Acquitaine Company of Canada Ltd., a company incorporated in 1963 with its head office located in Calgary, Alberta. 82.4% of the outstanding company shares are owned by Société Nationale des Pétroles d'Aquitaine, the remaining shares are owned by the public. Société Nationale des Pétroles d'Aquitaine is a French oil company, 51% of the capital stock of which is owned by a state agency of France.

Aquitaine Company of Canada Ltd. is currently engaged in oil and gas exploration and production in Canada directly and indirectly through its partially owned subsidiary Banff Oil Ltd.

The Brief points out that the company has serious reservations as to a substantial number of proposals of the White Paper, but has limited its submission to three points. These are:

(1) The application of capital gains tax to the sale by a non resident of its holdings of a widely held corporation. (Paragraph 6.47 of the White Paper).

(2) The application of the five year revaluation rule to common shares of a widely held corporation by a non resident. (Paragraphs 3.33 and 6.47 of the White Paper).

(3) The taxing of unrealized capital gains when a taxpayer leaves Canada. (Paragraph 3.40 of the White Paper).

In addition the Brief makes reference to the proposed method of taxing dividends, with particular reference to the procedures set forth in the White Paper as applicable to non resident shareholders. (Paragraphs 4.49 and 4.50 of the White Paper).

The attention of the Committee is drawn to the following comments:

(1) Relating to capital gains realized by non residents.

a. "Neither the United States nor the United Kingdom imposes capital gains tax on foreign shareholders as such and it appears to the Company that Canada's position in the international investing community would not be improved by the imposition of such a taxing system." (Page 5 of the Brief).

b. "Finally, even if it is accepted that such a tax might be imposed, the Company submits that the problems of collection and tax avoidance will be so difficult that the vast majority of transactions which should be subjected to tax will not be, in fact, collected or collectible by Canada. If the provisions of Paragraph 6.47 result in legislation, it is clear that it will give rise to a substantial growth in the use of bearer shares, unrecorded transfers and other easily available means of eliminating the impact of the tax, which elimination will be virtually impossible for Canada to cure, since it will have been effected by individuals or corporations over which Canada has no jurisdiction, domestically or internationally. The incidence of such unquestionable wide spread tax avoidance will bear particularly hard on those foreign investors who feel that they must abide by the law of Canada, notwithstanding their disagreement with the philosophy of its imposition and, in the long run, will lead to the decision of such types of foreign investors to avoid the investment rather than subject themselves to the potential tax." (Pages 7 and 8 of the Brief).

(2) Relating to five year revaluation.

"The Company must, therefore, urgently request that any doubts as to the non-applicability of the five-year revaluation rule to non-resident shareholders be eliminated.

It does, however, stress this point only as an ancillary recommendation to its primary request that both realized and unrealized gains of non-residents not be taxed, except possibly, if and to the extent such gains are realized in Canada as a result of a business carried on in Canada by a non-resident through a permanent establishment." (Pages 9 and 10 of the Brief).

(3) Relating to deemed realization on leaving Canada.

a. "Mobility of Canadian and foreign personnel is necessary in order to conduct international operations from foreign bases or from Canadian headquarters. If all unrealized gains are to be taxed whenever a person moves from Canada this will substantially impede the transfer of Canadians abroad or temporary assignments of foreigners to Canada. This impediment will be particularly onerous in the case of French individuals, since France does not impose a capital gains tax on individuals." (Page 10 of the Brief).

b. "A significant problem with imposition of capital gains tax on changes of residence is enforcement. Effective policing would require an extensive system of exit controls which would be almost impossible to implement on our borders. Short of isolating our country with curtain type restrictions, collection of the tax will largely depend on voluntary cooperation, and this may often be lacking if a person is moving abroad." (Page 11 of the Brief).

The attention of the Committee is specifically drawn to the general remarks of the Brief relating to the philosophy of Paragraphs 4.49 and 4.50 of the White Paper, dealing with the non allowance to foreign shareholders of a credit for Canadian corporation taxes paid. These are:

"The Company does not propose to deal at any length with the proposals of the White Paper on corporate distributions, except to note specifically the philosophy contained in Paragraphs 4.49 and 4.50, with which the Company disagrees. The law of France through the use of the preconte and avoir fiscal procedure imposes a system of taxing corporate distributions somewhat similar to that envisaged by the White Paper. In its original application, France took the same position as the White Paper that the privileges of the grossing up procedure and credit for corporate taxes paid should not be extended to foreign shareholders of French corporations. This decision by France met with almost universal condemnation, to the effect that, first in the case of West Germany and then in the case of the United States, France has given up its decision not to extend to foreign shareholders the credit for corporate taxes paid. The result of the French action, necessitated by the West German and United States objections, has been that France will not merely cancel all withholding tax on dividends from French companies to residents of these countries but will in addition, subsidize the governments of these countries by paying them an amount equal to the tax loss to these countries where they give their respective shareholders tax credit for the taxes paid to France." (Pages 12 and 13 of the Brief).

and concludes with the following:

"It seems to the Company, therefore, that a continuation of the existing system of taxing corporate dividends would be far more satisfactory than a plunge into the virtually unknown procedures contemplated by the White Paper, particularly if the assumptions of success are based on the types of misapprehension such as those reflected in Paragraphs 4.49 and 4.50." (Page 14 of the Brief).

The Brief submits:

(1) "The proposed tax on both realized and unrealized gains of non resident shareholders of both closely held and widely held Canadian corporations be eliminated." (Pages 14 and 15 of the Brief).

(2) "That the assumption of the White Paper that tax treaties between Canada and the various countries will be easily renegotiated is not correct." (Page 15 of the Brief).

There is attached the usual summary of present law, White Paper proposals and principal points of the Brief.

Name: AQUITAINE COMPANY OF CANADA LTD.

Principal Subject: Capital Gains tax
On sale by non resident controlling company

Present Tax Law	White Paper Proposals	Principal Points of Brief
	6.47 The same implications do not apply in the case of widely-held Canadian corporations. Canadian shareholders would receive credit for only half of the corporate tax paid and would be entitled to deduct only half of their loss on the sale of their shares. Also, it would be impracticable to attempt to tax non-residents on their sales of small lots of these shares. Therefore it is proposed that only those non-residents who are selling shares out of a substantial interest (25 per cent or more) would be taxable in Canada.	Pages 4 to 8 of the Brief The proposal to tax capital gains of non-resident shareholders, even where, in the case of WHC, limited to non-residents who are selling shares out of substantial interest, is inconsistent with generally accepted international tax principles and practices. To our knowledge, West Germany and the Netherlands are the only major western countries which attempt to levy a similar tax, and the experience of these two countries has apparently not been a happy one in this area. (Page 4 of the Brief). It might be noted, moreover, that the Organization for Economic Co-operation and Development Model Treaty which has been accepted by Canada (with reservations which do not affect this matter) appears to prohibit the country of incorporation from taxing capital gains of non-resident shareholders who have no other connection with the country of incorporation. It is difficult to conceive, therefore, why at this juncture, and in the face of ever increasing world pressure to eliminate this and equivalent types of taxes on foreigners, Canada should choose to attempt to impose such an unfair treatment on foreign shareholders. (Page 5 of the Brief). The Brief points out: (1) The proposed tax discriminates seriously against foreign shareholders of Canadian companies as compared to their Canadian counterparts. (2) It is possible that the foreign shareholder may not be able to receive relief for any tax imposed. (3) Difficulties would arise in collecting such a tax. (4) It will encourage wide spread tax avoidance, by the use of bearer shares and unrecorded transfers.

Name: AQUITAINE COMPANY OF CANADA LTD.

Principal Subject: Capital Gains
Five years revaluation

Present Tax Law	White Paper Proposals	Principal Points of Brief
	3.33 Taxpayers other than widely-held Canadian corporations would include only one-half of their gains on the sale of these shares in taxable income and deduct only one-half of their losses. However, they would be required to revalue these shares to market value every five years and take one-half of the resulting gain or loss into account for tax purposes in that year. A special rate is proposed for widely-held Canadian corporations to avoid double tax. This is explained in Chapter 4. 6.47 The same implications do not apply in the case of widely-held Canadian corporations. Canadian shareholders would receive credit for only half of the corporate tax paid and would be entitled to deduct only half of their loss on the sale of their shares. Also, it would be impracticable to attempt to tax non-residents on their sales of small lots of these shares. Therefore it is proposed that only those non-residents who are selling shares out of a substantial interest (25 per cent or more) would be taxable in Canada.	Pages 8 to 10 of the Brief The Brief makes the following comment: The Company must, therefore, urgently request that any doubts as to the non-applicability of the five-year re-valuation rule to non-resident shareholders be eliminated. It does, however, stress this point only as an ancillary recommendation to its primary request that both realized and unrealized gains of non-residents not be taxed, except possibly, if and to the extent such gains are realized in Canada as a result of a business carried on in Canada by a non-resident through a permanent establishment. (Pages 9 and 10 of the Brief).

Name: AQUITAINE COMPANY OF CANADA LTD.

Principal Subject: Capital Gains.
Unrealized on taxpayer leaving Canada

Present Tax Law	White Paper Proposals	Principal Points of Brief
	3.40 The other deemed realization would occur when a taxpayer gives up Canadian residence. The general rule would be that he would be treated as if he had sold all his assets on that day at their fair market value. On the other hand, when a taxpayer moves to Canada he would generally be treated as though he had on that day purchased his assets at their fair market value. The combination of these two rules would mean that Canada would tax only the increase in value that arises during the time that the owner is resident in Canada.	Pages 10 to 12 of the Brief. The Brief points out: Mobility of Canadian and foreign personnel is necessary in order to conduct international operations from foreign bases or from Canadian headquarters. If all unrealized gains are to be taxed whenever a person moves from Canada this will substantially impede the transfer of Canadians abroad or temporary assignments of foreigners to Canada. This impediment will be particularly onerous in the case of French individuals, since France does not impose a capital gains tax on individuals. (Page 10 of the Brief). The Brief suggests: In order to avoid such a "freezing" of personnel, the Company proposes that such tax be eliminated or at the very least capital gains taxes not be imposed after short term periods of residence in Canada or if long term Canadian residents intend to become foreign residents for a limited time. It is appreciated that the latter case may present problems because it may be difficult to determine when a resident leaves, how long he will in fact stay away. Adequate safeguards could, however, probably be taken to ensure payment of capital gains tax if such person remained abroad for more than a limited time. (Pages 10 and 11 of the Brief). And there seems to be every good reason why Canada should not impose such a tax. The Company urges this result or at least that the tax be limited to those instances where permanent and long term changes in residence are involved. (Pages 11 and 12 of the Brief).

APPENDIX "E"

INTERNATIONAL UTILITIES CORPORATION

200 UNIVERSITY AVENUE TORONTO 1, ONTARIO, CANADA

SUBMISSION

TO THE

STANDING SENATE COMMITTEE

ON BANKING, TRADE AND COMMERCE

ON PROPOSALS FOR TAX REFORM 1969

May, 1970

SUMMARY OF PROPOSALS OF INTERNATIONAL UTILITIES CORPORATION ("IU") IN RESPECT OF THE WHITE PAPER ON TAX REFORM

THE FOLLOWING IS A SUMMARY OF THE PROPOSALS MADE BY IU IN ITS ATTACHED BRIEF TO THE COMMITTEE

I. RESIDENCE

1. CORPORATIONS INCORPORATED IN JURISDICTIONS OUTSIDE OF CANADA BUT WITH HEADQUARTERS IN CANADA WHICH CONDUCT THEIR BUSINESS AS CANADIAN RESIDENTS UNDER PRESENT LAW SHOULD BE PERMITTED TO RETAIN THEIR CANADIAN DOMICILE FOR TAX PURPOSES SO THAT ALL OF THEIR INCOME REMAINS TAXABLE BY CANADA AND THEIR CANADIAN SHAREHOLDERS CONTINUE TO QUALIFY FOR DIVIDEND TAX CREDITS OR THE PROPOSED INTEGRATED CREDIT SYSTEM.

2. IF FOREIGN CORPORATIONS ARE GENERALLY MADE INELIGIBLE FOR TAX RESIDENCY IN CANADA, AN EXCEPTION SHOULD BE CREATED FOR THOSE WHOSE CANADIAN RESIDENCE HAS BEEN MAINTAINED FOR A SUBSTANTIAL PERIOD AND WHOSE SHARES HAVE BEEN LISTED DURING THAT PERIOD ON ONE OR MORE CANADIAN STOCK EXCHANGES.

II. DIVIDENDS

1. SHAREHOLDERS OF CANADIAN STEAM, GAS AND ELECTRIC UTILITIES SHOULD NOT BE DENIED DIVIDEND TAX CREDITS UNDER THE PROPOSED NEW SYSTEM OF CREDITABLE TAX SIMPLY BECAUSE THE PROVINCES SHARE A LARGER PORTION OF TAXES PAID BY UTILITIES THAN IS SHARED IN THE CASE OF INDUSTRIAL COMPANIES.

2. IF AN INTEGRATED SYSTEM IS ENACTED, CANADIAN SHAREHOLDERS SHOULD BE ALLOWED A CREDIT FOR FOREIGN COR-

PORATE TAXES PAID AS WELL AS CANADIAN TAXES; OTHERWISE EXISTING INTERNATIONAL CANADIAN COMPANIES WILL BE LESS ATTRACTIVE TO CANADIAN INVESTORS AND INTERNATIONAL EXPANSION WILL BE DISCOURAGED.

III. CAPITAL GAINS

1. THE FIVE YEAR REVALUATION PROPOSAL SHOULD BE REJECTED AS CONTRARY TO ESTABLISHED TAX PRACTICE THROUGHOUT THE WORLD OF TAXING ONLY REALIZED PROFITS.

2. THE INITIAL VALUES ESTABLISHED ON VALUATION DAY SHOULD BE THE HIGHER OF COST OR MARKET VALUE.

3. VALUATION DAY SHOULD BE FIXED AS OF A DATE AFTER THE NEW LAW HAS BEEN ENACTED.

4. THE DEEMED REALIZATION OF CAPITAL GAINS UPON LEAVING CANADA SHOULD BE ELIMINATED SINCE THE PROPOSED RULE WOULD UNDULY RESTRICT THE MOVEMENT OF PERSONNEL, PARTICULARLY BETWEEN CANADA, THE U.K. AND THE U.S.

IV. PASSIVE INCOME

1. THE PASSIVE INCOME PROVISIONS OF U.S. SUBPART F SHOULD NOT BE ENACTED BY CANADA SINCE THEY HAVE PROVEN INEFFECTIVE AND UNADMINISTRABLE IN THE UNITED STATES.

INTRODUCTION

International Utilities Corporation ("IU") was incorporated in 1924 in the State of Maryland in the United States. Since 1961 IU has been headquartered in Toronto and has been treated as a resident of Canada for tax purposes since the management and control of its affairs has been effected in Canada by IU's predominately Canadian Board of Directors and Executive Committee. IU files tax returns and pays Canadian taxes on the same basis as any other corporate taxpayer.

IU, which operates principally through subsidiaries, had at year-end total assets of $1.3 billion, 1969 revenues of approximately $800 million and net income of $35.8 million. IU's accounts are stated in Canadian dollars. IU's activities include a world-wide shipping business, electric and gas utilities, mining, transportation and industrial operations in Canada, water utilities, trucking, land development and industrial operations in the United States and various businesses abroad.

The capital stock of IU is listed on the Toronto, Montreal and Vancouver stock exchanges as well as the New York and Philadelphia-Baltimore-Washington exchanges. Other securities of the company are listed on the London and Luxembourg exchanges. Almost 15,000 of IU's 26,000 shareholders reside in Canada. Canadians own approximately 68% of the company's outstanding common stock and approximately 49% of all classes of outstanding stock. Approximately 49% of all classes combined are owned in the U.S. and 2% are owned overseas.

IU's comments made in this submission are restricted to four specific areas covered by the White Paper: (1) the question of residency of foreign corporations, (2) applicability of the new dividend credit system to shareholders of utility companies and shareholders of international companies in general (3) the deemed realization of capital gains every five years or upon leaving Canada, and (4) the passive income proposals.

I. RESIDENCE

1. CORPORATIONS INCORPORATED IN JURISDICTIONS OUTSIDE OF CANADA BUT WITH HEADQUARTERS IN CANADA WHICH CONDUCT THEIR BUSINESS AS CANADIAN RESIDENTS UNDER PRESENT LAW SHOULD BE PERMITTED TO RETAIN THEIR CANADIAN DOMICILE FOR TAX PURPOSES SO THAT ALL OF THEIR INCOME REMAINS TAXABLE BY CANADA AND THEIR CANADIAN SHAREHOLDERS CONTINUE TO QUALIFY FOR DIVIDEND TAX CREDITS OR THE PROPOSED INTEGRATED CREDIT SYSTEM.

Sections 4.66 and 4.67 of the White Paper read as follows:

> "4.66 The present dividend tax credit applies to dividends received from taxable Canadian corporations. This phrase can cover all corporations resident in Canada whether or not they are incorporated under Canadian laws. As part of its program to improve the effectiveness of the tax system, the government proposes to remove some of the distinctions now made between corporations on the basis of residence and to distinguish instead on the basis of the place of incorporation. (It is possible for foreign corporations to move out of Canadian jurisdiction entirely. This type of manoeuvre is not open to corporations created under Canadian law.) Under the new proposals, the system of credits for corporate tax would apply only to corporations incorporated in Canada.
>
> "4.67 This provision could mean a substantial

change to some foreign corporations which now are resident in Canada and whose dividends now qualify for the dividend tax credit. Consequently it is proposed that dividends from these corporations be treated the same as dividends from Canadian corporations for a temporary period of five years in order to give them time to rearrange their affairs to conform with the new tax laws."

IU has held discussions with the Department of Finance in order to grasp the logic behind the foregoing proposal, which would overrule the long standing Canadian, United Kingdom and Commonwealth tax principle that the tax situs of a corporation depends on substance, not form, i.e., situs is determined by looking to not only the jurisdiction of incorporation but to the actual location of the business and principal place of its direction and control by the Board of Directors. We believe that the change was proposed for the principal purpose of:

(1) Bringing all corporations incorporated in Canada within Canada's taxing jurisdiction; and

(2) Eliminating tax avoidance caused by foreign corporations resident in Canada terminating their residency at will.

We believe that both these purposes can be served without altering the long standing rule permitting a controlled foreign corporation to reside in Canada for tax purposes.

The basic doctrine of tax residency was clearly set forth in DeBeers Consolidated Mines Limited v. Howe (1906) A.C. 455 by Lord Loreburn, L.C. at page 458:

> "An individual may be of foreign nationality, and yet reside in the United Kingdom. So may a company. Otherwise it might have its chief seat of management and its centre of trading in England under the protection of English law, and yet escape the appropriate taxation by the simple expedient of being registered abroad and distributing its dividends abroad. The decision of Kelly C.B. and Huddleston B. in the Calcutta Jute Mills v. Nicholson and the Cesna Sulphur Co. v. Nicholson, now thirty years ago, involved the principle that a company resides for purposes of income tax where the real business is carried on. Those decisions have been acted upon ever since. I regard that as the true rule, and the real business is carried on where the central management and control actually abides."

The effect of this long standing principle was to prevent corporations from selecting tax haven or other jurisdictions in which to incorporate, then operating from and under the protection of Canada without subjecting all of their income to Canadian taxation.

Whereas Canada has distinguished between resident and non-resident corporations on a control theory, other countries, such as the United States, have given foreign corporations deemed residence and local corporations deemed non-residence for certain purposes based on their percentage of local income. For example, IU is itself exempted from U.S. withholding taxes on dividends paid to Canadians and other non-U.S. residents because over 80% of its gross income (as defined by the U.S.Internal Revenue Code) comes from sources outside the U.S. (See Section 862 of the Internal Revenue Code). Similarly a U.S. corporate shareholder

which receives dividends from a foreign corporation which earns most of its income in the U.S. obtains a dividend received deduction (as if it had received the dividend from another U.S. corporation) similar to the proposed dividend tax credit in Canada. (See Section 245 of the Internal Revenue Code).

The U.S. does, however, subject all corporations incorporated there to taxation, as would Canada under the White Paper proposals. IU agrees with this aspect of the proposals (which is now the law for post April, 1965 incorporations) - that all corporations incorporated in Canada and receiving the protection of Canadian law for their legal existence should be taxable in Canada. We do not, however, agree that all corporations incorporated elsewhere should be precluded from maintaining tax residency in Canada. We submit that where a foreign corporation is by choice located in Canada, it should for all purposes be treated as a Canadian taxpayer in the same manner as corporations actually incorporated here.

The jurisdiction of incorporation of many long established companies is largely an accident of history. When IU was incorporated in Maryland in 1924 its properties and share ownership were largely U.S. In 1961 when IU came to Canada substantially all of IU's operating income was earned in Canada and about 42% of its stock was in Canadian hands. That share ownership has steadily increased since 1961 as shown in Exhibit A hereto, which reflects historic geographic distribution of IU shareholders, and Exhibit B,

which reflects distribution of share ownership.

IU and other foreign corporations cannot achieve desired Canadian residency by simply reincorporating in Canada because in the case of IU, substantial tax costs would be involved, as well as serious problems of corporate structural changes. In some cases foreign laws make no provision for domicile changes by locally incorporated companies.

Turning now to the Finance Minister's rationale for excluding companies like IU from tax residency, we see that it is based almost entirely on the potential revenue loss involved because foreign companies resident in Canada can "go home" or escape Canadian jurisdiction at any time without suffering adverse consequences. We submit that there are two defects in this rationale: first, that the continued Canadian tax residency of foreign corporations should increase, not reduce tax revenues; and second, that reasonable restrictions can readily be placed upon the mobility of foreign corporations resident in Canada.

As to the matter of effect upon Canadian tax revenues, the effect of the long established residency rule was to keep Canadian taxpayers from setting up Canadian controlled foreign corporations for the purpose of avoiding Canadian taxing jurisdiction. This will apparently be permitted under the White Paper proposals. Although we cannot accurately estimate the potential revenue loss involved, we suggest that it could be substantial. The basic effect of Canadian tax residency is to make all of

the income of a foreign corporation, including capital gains as proposed in the White Paper, fully taxable in Canada. It is submitted that very few foreign corporations will elect voluntarily to become fully taxable in Canada after enactment of a capital gains tax, unless a very substantial portion of their equity securities are owned in Canada. Where substantial Canadian ownership exists and control is exercised by Canadians in Canada, why not make the corporation fully taxable?

For many years now Canada has successfully created a favourable economic, political and tax climate which has made this country an advantageous place to locate and manage international businesses. IU has been a proud beneficiary of this policy and its shares have enjoyed a steadily increasing Canadian ownership for ten straight years. For IU and other foreign corporations to lose their tax residence in Canada will simply cause their shares to shift across the border to the United States and gradually eliminate Canadian ownership, a result which is exactly contrary to the long established policy of encouraging Canadian ownership of Canadian and international businesses. We submit that this should not be allowed to occur simply because foreign corporations located in Canada might hypothetically move from Canada.

As to what may constitute a reasonable restriction upon moving from Canada, IU suggests that an equitable restriction on foreign corporations resident in Canada would be a provision to the effect that a change in residence be

subject to administrative review whenever it is found that its principal purpose is the avoidance of Canadian taxes. This should act to discourage foreign corporations from coming and going from Canada as they please.

As a further restriction to eliminate elective residency for the purpose of avoiding Canadian taxes, IU proposes that foreign subsidiaries of companies domiciled outside of Canada be ineligible to maintain tax residency in Canada. This will preclude a foreign company from seting up a foreign corporate subsidiary resident in Canada, which can operate in Canada without paying the branch operation tax of 15% and without paying Canadian withholding taxes if it terminates residency and then pays its Canadian profits out to its parent.

A final factor to consider with respect to Canadian tax residency of foreign corporations managed in Canada is that such residency, if elected, subjects the dividends paid out by the foreign corporation to non-Canadians to Canadian withholding taxes. Canada has received millions of dollars from IU alone in this respect since 1961. IU has paid annually increasing cash dividends for the past twenty-five years to its combined group of Canadian, U.S. and other shareholders. Should IU's Canadian residency be terminated as proposed by the White Paper, none of its operating or capital gains income will be subject to tax in Canada and its dividends to U.S. and overseas shareholders will be exempt from Canadian withholding taxes.

2. IF FOREIGN CORPORATIONS ARE GENERALLY MADE INELIGIBLE FOR TAX RESIDENCY IN CANADA, AN EXCEPTION SHOULD BE CREATED FOR THOSE WHOSE CANADIAN RESIDENCE HAS BEEN MAINTAINED FOR A SUBSTANTIAL PERIOD AND WHOSE SHARES HAVE BEEN LISTED DURING THAT PERIOD ON ONE OR MORE CANADIAN STOCK EXCHANGES.

If Parliament should nevertheless decide to render foreign corporations generally ineligible for Canadian tax residency, we propose that an exception be carved out for publicly owned companies which have been domiciled and listed in Canada for a substantial period, say 5 or 10 years. This exception would avoid the retroactive penalty to be suffered by many Canadians who purchased IU as a Canadian company, fully expecting that it would continue to be so treated. Moreover, the vast majority of tax avoidance cases involve foreign subsidiaries of foreign companies and corporations created by a handful of Canadian or non-Canadian residents. A public company with widely distributed share ownership in Canada and elsewhere is simply not geared to engage in tax manipulations across international borders. Accordingly, existing public companies with substantial Canadian ownership should be permitted to continue their management and identification as corporate residents of Canada.

We suggest that Canada has nothing whatever to lose in carving out such an exception so as to permit IU and other companies similarly situated to retain their Canadian identity and orientation. On the other hand, Canada stands to lose a substantial international company

headquartered in Canada by making IU ineligible for tax residency here, since its share ownership will inevitably flow quickly from Canada to the U.S. and elswhere should its Canadian shareholders be deprived of the proposed dividend credit system for corporate tax.

In summary, IU looks forward to its continued Canadian status following enactment of the White Paper proposals either by means of an exception to the proposed general rule or by a modification of the White Paper proposal to provide that whereas all Canadian corporations will become taxpayers, Canadian tax residence will still be available to foreign corporations which meet the standards of existing law.

II. DIVIDENDS

1. SHAREHOLDERS OF CANADIAN STEAM, GAS AND ELECTRIC UTILITIES SHOULD NOT BE DENIED DIVIDEND TAX CREDITS UNDER THE PROPOSED NEW SYSTEM OF CREDITABLE TAX SIMPLY BECAUSE THE PROVINCES SHARE A LARGER PORTION OF TAXES PAID BY UTILITIES THAN IS SHARED IN THE CASE OF INDUSTRIAL COMPANIES.

Sections 4.63, 4.64 and 4.65 of the White Paper read as follows:

"4.63 In 1966, Parliament passed the Public Utilities Income Tax Transfer Act under which the Minister of Finance turns over to the provincial governments 95 per cent of the corporation tax collected from certain electric, steam and gas utility corporations.

"4.64 The whole scheme of the present proposals contemplates that shareholders of Canadian corporations receive a credit from the federal government for part or all of the federal corporation tax paid by their corporation. It would be contrary to this general scheme if the federal government gave to shareholders of these utility corporations credit for taxes which the federal government has turned over to the provincial governments, and it does not propose to do so.

"4.65 It would be possible to give the shareholders credit for the taxes which the federal government retains. However, the amounts would be very small and the government considers it more

efficient to ask Parliament to amend the Public Utilities Income Transfer Act so that all of these taxes are turned over to the provinces, who could then decide to what extent they should be turned over to the corporation or its shareholders."

If the foregoing proposal is enacted, IU will have very little "creditable tax" to pass on to its Canadian shareholders because substantially all of its Canadian income is derived from Canadian gas and electric utility companies operating principally in the Province of Alberta. In this submission we do not intend to repeat the detailed arguments and analysis contained in submissions previously filed by four IU companies (Canadian Utilities, Limited, Canadian Western Natural Gas Company, Limited, Northland Utilities Limited and Northwestern Utilities Limited), the Canadian Gas Association and other investor-owned Canadian utilities. We propose simply to outline briefly what we consider to be the principal arguments against the singling out of utilities for separate treatment in the White Paper.

The first and most important point to be made is that gas and electric utilities are in fact taxed like any other corporation. Nowhere else in the White Paper is a modification made in the applicable dividend credit provisions because of any sharing of tax revenues between the federal and provincial governments. The fact that 95% or more of the tax revenues generated from utilities ends up (after three years) in the hands of the provinces does

not justify treating utilities as if they have paid no taxes at all. All corporations pay taxes which are shared by the federal and provincial governments, but there is no mention in the White Paper of taking the provincial share of revenues out from under the creditable tax of a shareholder. Thus, for the sake of consistency alone, utilities should be given the same treatment as industrial and other corporations.

As has been pointed out in the prior submissions, the proposed elimination of tax credits for utility companies has already dealt a serious blow to the market value of Canadian utilities in general. It can be expected that enactment of the proposal would further depress market prices to such an extent that Canada would be virtually eliminated as a source for the much needed capital funds which will keep Canada's investor-owned utilities on a financially stable course in the future. The prior submissions have also incontestably established the growing need for equity funds to meet the growth requirements of this country's utility systems.

The result of a disappearing equity market for utility shares in Canada will inevitably be the increased foreign ownership of these companies, a goal certainly not intended in the proposals for tax reform. Should the market for additional equity financing deteriorate much more, Canadian utilities may be forced simply to eliminate dividends entirely in order to keep their equity-debt balance intact. This would cause Canada to lose the revenues other-

wise payable out of utility dividends and turn utility companies into purely speculative (or capital gain) investments.

The White Paper proposals would clearly cause utility rate increases throughout Canada in order to keep utility shares on as competitive a basis as possible with other industries. This means robbing Peter to pay Paul - money flows out of the hands of customers in order to put a rightful after tax dividend in the hands of utility shareholders.

For the foregoing reasons IU respectfully proposes that Sections 4.63 through 4.65 be eliminated from the White Paper as enacted.

2. IF AN INTEGRATED SYSTEM IS ENACTED, CANADIAN SHAREHOLDERS SHOULD BE ALLOWED A CREDIT FOR FOREIGN CORPORATE TAXES PAID AS WELL AS CANADIAN TAXES; OTHERWISE EXISTING INTERNATIONAL CANADIAN COMPANIES WILL BE LESS ATTRACTIVE TO CANADIAN INVESTORS AND INTERNATIONAL EXPANSION WILL BE DISCOURAGED.

The White Paper proposals would restrict the Canadian shareholder's dividend tax credit by allowing only (1) Canadian taxes paid and (2) up to 15% of foreign dividend withholding taxes as a credit to the shareholder. The failure to include all foreign taxes within the definition of creditable tax causes discrimination against Canadian shareholders of Canadian companies which have substantial foreign operations and tends to discourage foreign investment by Canadian companies. Moreover, it may even

encourage additional foreign ownership of Canadian companies. IU and other international companies which pay their dividends out of profits earned within and outside of Canada will invariably have less creditable tax to pass on to shareholders than companies with only Canadian operations. The principal effect of excluding foreign taxes from the computation of creditable tax is that Canadian shareholders are taxed twice on profits earned outside of Canada, a result that we submit cannot be reconciled with the concept of integration set forth in the White Paper.

Canadian companies should be encouraged to seek expansion abroad; however, the exclusion of foreign taxes from the tax credit computation should prove a powerful disincentive for Canadian companies to seek any such expansion. The limited size of the Canadian market for goods and services has inevitably caused most major industrial companies to expand abroad. Under the White Paper proposals their shareholders are now to be penalized for growth so achieved.

On the question of encouraging additional foreign ownership, the potential reduction in after tax yield for Canadian shareholders of international companies will act to decrease the market value of such equities, thereby inviting bargain hunting by foreign shareholders and foreign corporations.

If Parliament should decide against making foreign taxes creditable, we suggest at the very least that the integrated credit computation be clarified to provide

that the amount of creditable tax of a corporation is not diminished by dividends paid out to non-Canadian shareholders. This will avoid any penalty suffered by Canadian shareholders of IU and other international companies because of the international character of their share ownership.

For these reasons we submit that creditable tax should include taxes paid to foreign jurisdictions.

CAPITAL GAINS

1. THE FIVE YEAR REVALUATION PROPOSAL SHOULD BE REJECTED AS CONTRARY TO ESTABLISHED TAX PRACTICE THROUGHOUT THE WORLD OF TAXING ONLY REALIZED PROFITS.

Perhaps the most novel and controversial section of the White Paper is the deemed realization of capital gains every five years by shareholders of widely held Canadian companies. We suggest that this departure from established tax practice is unjustifiable and unwarranted, particularly with respect to controlling interests in widely held Canadian companies. Most individuals holding controlling interests in public companies will be forced to liquidate part of their investments (and perhaps their control) in order to meet the cost of a deemed tax on capital appreciation.

The five year deemed realization of capital gains makes no sense whatever when applied to controlling interests in public Canadian companies held by IU and other Canadian holding companies because it appears to result in effective double taxation of Canadian shareholders. For example, Canadian shareholders of IU would be required to pay the five year tax on the appreciated value of IU (whose market value includes the value of its public Canadian subsidiaries) and in addition IU itself would be required to pay the same five year tax with respect to the appreciated value of its publicly owned Canadian subsidiaries. Thus, a Canadian shareholder of IU ends up paying tax twice on the market value of IU's public Canadian sub-

sidiaries. We propose that at the very least a public Canadian company which owns a substantial interest in another public Canadian company should be exempted from the proposed five year tax.

An extreme case illustrating the onerous results of taxing Canadian holding companies is presented by a holding company whose only subsidiary is another publicly owned Canadian company. In that case the market value of the holding company's stock would consist entirely of the underlying value of its public subsidiary. Here a Canadian shareholder of the holding company would be subject to the five year tax on the identical appreciation to which the holding company itself is subject. The economic consequence is for the shareholder to suffer twice (once directly and once indirectly) the tax which would have been payable only once had he simply held shares of the public subsidiary.

We submit, therefore, that the five year deemed realization of capital gains should not be enacted because it contravenes the basic doctrine that taxes only accrue where profits are actually realized and the proceeds thereof are available to pay the tax.

2. THE INITIAL VALUES ESTABLISHED ON VALUATION DAY SHOULD BE THE HIGHER OF COST OR MARKET VALUE.

IU submits that a taxpayer should not be taxed on a capital gain based upon a transaction in which he suffered an economic loss. This will be the result in many cases where a taxpayer's original cost exceeds his valua-

tion day value. We thus suggest that the initial values established on valuation day should be the higher of cost or market value. We understand that use of the higher of cost or market value concept has been accepted by taxing authorities in other countries, including the United States, upon the introduction of a capital gains tax. It seems only fair that Canada do likewise.

3. VALUATION DAY SHOULD BE FIXED AS OF A DATE AFTER THE NEW LAW HAS BEEN ENACTED.

On the general question of the value upon which gains are determined, a valuation date should be selected to give every taxpayer a fair starting point. The discriminatory treatment of Canadian utility companies and their shareholders under the White Paper as proposed has resulted in a substantial decrease in the market value of utility stocks. These depressed values should not be used to compute capital gains unless the law itself should treat utility shareholders in the manner proposed by the White Paper. To avoid this unfair treatment, valuation date should logically either be a date prior to the publication of the White Paper or a date after passage of the law itself. Since the earlier date is probably impractical due to the passage of time between the proposal date and the date of effective legislation, we suggest that valuation day be a date subsequent to the passage of legislation so that the market can reflect the impact of the legislation.

This would prevent the taxation of a gain created solely by the proposals of the White Paper and would elimi-

nate the advantage given stockholders of some companies whose stock may have risen substantially as the result of White Paper proposals which may not be enacted.

4. THE DEEMED REALIZATION OF CAPITAL GAINS UPON LEAVING CANADA SHOULD BE ELIMINATED SINCE THE PROPOSED RULE WOULD UNDULY RESTRICT THE MOVEMENT OF PERSONNEL, PARTICULARLY BETWEEN CANADA, THE U.K. AND THE U.S.

Section 3.40 of the White Paper provides for a deemed realization of capital gains when a taxpayer gives up Canadian residence. The taxpayer would be treated as though he had sold all his assets on the day of his move at their fair market value. This means that a Canadian resident who holds substantial appreciated assets may find it difficult, if not impossible, to effect a change of residence to another country during the course of his business career, even though he may well return to Canada as a resident in the future. We suggest that it is of vital importance for Canada to maintain a climate which encourages the free movement of people both to and from its boundaries.

Because a Canadian employer would normally be expected to reimburse an employee for part of this tax, the tax on employees leaving Canada will in many cases be a tax on the employer itself. This may cause many companies not to make a management shift crossing international boundaries which would otherwise be highly advantageous to the employee. Moreover, Canadian companies may be discouraged from bringing additional employees or management

staff to Canada from foreign countries because of the severe penalty connected with their eventual return to their home country.

We believe it is fair to say that most Canadians who terminate their residence in Canada in order to pursue a career within an international company eventually return to Canada, either during their business career or at retirement. We also suggest that there will be little loss of revenue to the Canadian treasury if Section 3.40 of the White Paper proposals is eliminated.

IV. PASSIVE INCOME

1. THE PASSIVE INCOME PROVISIONS OF U.S. SUBPART F SHOULD NOT BE ENACTED BY CANADA SINCE THEY HAVE PROVEN INEFFECTIVE AND UNADMINISTRABLE IN THE UNITED STATES.

The White Paper suggests that proposals will be introduced patterned generally to those in the United States known as "Subpart F" concerning the foreign operations of Canadian companies.

Subpart F was enacted in 1962 and is one of the most complex areas of the U.S. Internal Revenue Code. It generally provides that certain types of income of foreign subsidiaries are deemed to be "Subpart F" income, which is taxable to the parent corporation when accrued in a foreign subsidiary. Subpart F income consists of investment income, service income and sales income.

Because of the severe penalties to which Subpart F subjects U.S. companies competing abroad, it was enacted with many qualifications and exceptions in order to allow U.S. companies with activities abroad which are not connected with tax avoidance to meet their foreign competition. Many expert tax planners within and outside of the U.S. Internal Revenue Service have found the Subpart F provisions difficult to administer and generally ineffective in preventing the tax avoidance at which it was aimed. We suggest that it would be an error for Canada to introduce legislation modeled after the Subpart F rules, which are presently under study, and are subject to major revision by

the U.S. Treasury Department.

As to the application of Subpart F to IU, we are particularly interested in continuing the practice of making investments in marketable securities through subsidiaries incorporated in the country in which the marketable securities are located. IU's marketable securities purchased in the United States are owned by a subsidiary (International Utilities Investment Corporation) incorporated in the United States. The making of such investments in marketable securities constitutes a long standing and legitimate business practice of IU but which IU would be unable to continue with respect to U.S. investments if Canada should enact a U.S. style Subpart F.

We therefore urge that the Subpart F provisions of the U.S. Internal Revenue Code, either in their current form or as modified, be eliminated from the White Paper proposals.

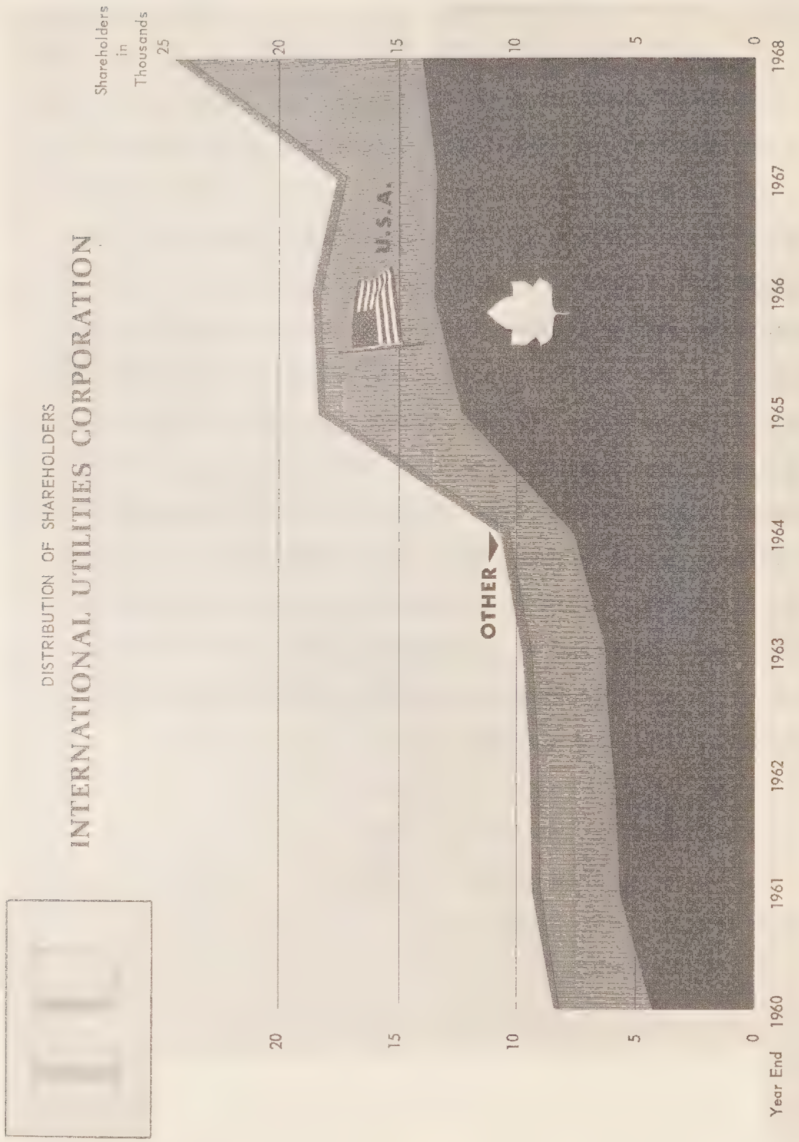

IUC
DISTRIBUTION OF SHAREHOLDERS
INTERNATIONAL UTILITIES CORPORATION
Shareholders in Thousands
25
20
15
10
5
0
U.S.A.
OTHER
Year End
1960
1961
1962
1963
1964
1965
1966
1967
1968

EXHIBIT A

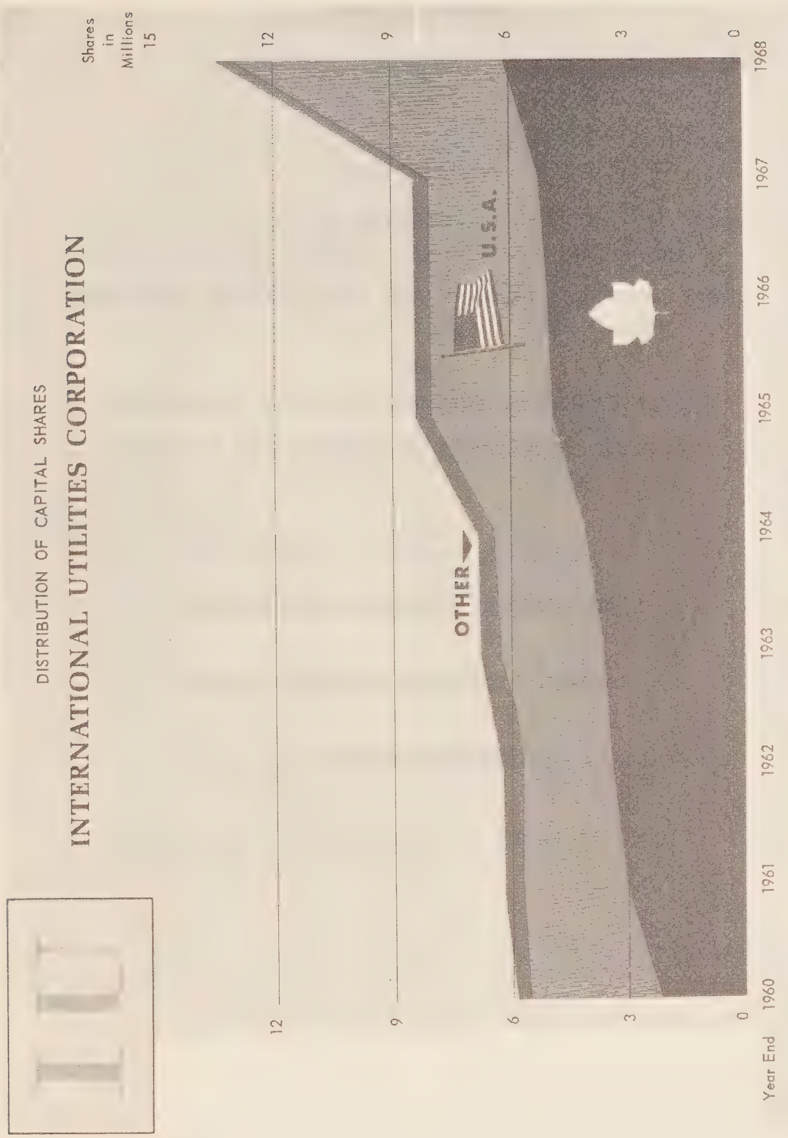

IUC
DISTRIBUTION OF CAPITAL SHARES
INTERNATIONAL UTILITIES CORPORATION
Shares in Millions
15
12
9
6
3
0
OTHER
U.S.A.
Year End
1960
1961
1962
1963
1964
1965
1966
1967
1968

EXHIBIT B

APPENDIX "F"

SUBMISSION BY

KING RESOURCES COMPANY AND ITS CANADIAN EMPLOYEES

TO

THE SENATE COMMITTEE ON BANKING AND FINANCE

AND

THE HOUSE OF COMMONS COMMITTEE ON

FINANCE, TRADE AND ECONOMIC AFFAIRS

WITH RESPECT TO

THE WHITE PAPER ON PROPOSALS FOR TAX REFORM

SUMMARY AND CONCLUSIONS

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SUMMARY AND CONCLUSIONS

In our opinion the White Paper Proposals for Tax Reform will have the following undesirable effects:

1. They will work an injustice on those who have taken extraordinary risks, and made extraordinary sacrifices, in their investments and their business undertakings.

2. They will reduce incentive for Canadians to save and create investment capital.

3. They will reduce Canada's world competitive position for foreign investment.

4. They will continue the advantages which foreign investors enjoy over Canadian investors in the area of Canadian natural resources.

5. They will impede the establishment of Canadian public companies.

6. They will reduce the attractiveness of investment in the natural resource industries.

7. They will encourage enterprising Canadians to emigrate to the United States because of the substantial difference in personal tax rates between Canada and the United States.

8. They will cause a major increase in centralization of investment power at the expense of individual freedom.

9. They will cause many taxpayers to lose their respect for the tax system.

Our recommendations for changes to the Proposals which would improve their effectiveness are as follows:

1. Capital gains should be taxed separately from regular income, and certainly with no more severe treatment than in the United States.

2. There should be no deemed realization of capital gains under any circumstances.

3. Foreign corporations doing a significant portion of their business in Canada should be treated as widely-held Canadian corporations.

4. The 21% tax on the first $35,000 of corporate taxable income should be retained, or alternative incentives should be provided for small businesses to be formed and to grow.

5. Meaningful incentives for the risk-taking extractive industries should be ensured.

6. The right should be provided for any Canadian individual, partnership or corporation to write-off all expenses incurred in exploration for petroleum, natural gas or other minerals against ordinary income, in the year incurred.

Our detailed reasons for the above recommendations follow:

SUBMISSION BY KING RESOURCES COMPANY AND ITS CANADIAN EMPLOYEES

This brief is submitted by senior employees of King Resources Company on behalf of themselves, and on behalf of the Canadian Division of King Resources Company.

The employees who present this submission are all Canadian citizens. Our concern naturally shows a broader spectrum than that of King Resources Company, as to the consequences of implementing the Proposals for Tax Reform as they stand. While we are in complete support of the technical recommendations, herein contained, that are of immediate concern to our company, we are also personally concerned with the social and economic consequences of implementing the proposals as written. We believe that the net effect of such implementation will be to erode the quality and substance of our lives as Canadians.

KING RESOURCES COMPANY

King Resources Company is an independent resource development company, incorporated in the United States, and operating in the United States, Canada, the Middle East, South Africa, the Caribbean, and in other areas of the world. The company was incorporated in 1960 and has experienced substantial growth since that time. It first commenced operations in Canada

in 1962 and now owns petroleum, natural gas and other mineral rights in the Provinces of Ontario, Manitoba, Saskatchewan, Alberta, and British Columbia, as well as in the Northwest Territories, including the Arctic Islands.

The company now employs approximately 120 people in its Canadian operations, virtually all of whom are Canadians. In addition, several Canadians who were previously employed in Canada are now associated with other worldwide operations of the company.

King Resources Company presently operates in Canada as a branch of an American corporation. During 1969 the company attempted forming a separate organization for the conduct of its Canadian operations, with the intention of offering equity participation in this organization to Canadians. The existing tax laws of Canada and the United States have made the formation of this new corporation extremely difficult and certain aspects of the recent Proposals for Tax Reform would now seem to prohibit the formation of such a Canadian organization.

Companies associated with King Resources Company manage and invest in Canada, funds generated by mass-distributed limited partnerships formed in the United States. Over the last year, the company has conducted extensive negotiations

concerning the formation of similar limited partnerships in Canada, to provide a vehicle for the diversified investment, by Canadians, in the Canadian natural resource field. The current Canadian tax laws severely limit the number of people able to participate in such partnerships, and while the Proposals for Tax Reform do remove this inequity to a degree, they do not materially encourage investment by Canadians in their own natural resources.

Notwithstanding the difficulties encountered in the formation of a separate Canadian entity, the company has recently taken steps to list its shares on the Toronto Stock Exchange, thereby encouraging Canadians to participate in ownership of the company. It is the company's intention, provided it is not impeded by tax laws of either Canada or the United States, to do whatever is in its power to actively encourage equity participation by Canadians in the company, and in the company's Canadian operations.

GENERAL COMMENTS

We should like to commend the Government for the attempt it is making to modernize the tax structure of Canada. The job is a difficult one and all members of Government have our sympathy in attempting this task. We also applaud the decision to seek criticism of their proposals before enacting

them into law. It is in the sincere hope that our comments will assist in the creation of a better Canada that this submission is offered.

Mr. Benson has stated that none of the proposals in the White Paper are sacred, but that the final package must meet the following goals for tax reform:

- Fair distribution of the tax burden based on ability to pay.
- Steady economic growth and continuing prosperity.
- Recognition of modern social needs.
- Production of the same initial revenue as existing laws and rates.
- An effective self-assessing system.
- A system that can and will be used by the Provinces.

In these general comments, we will strive to assess the ability of the proposals to satisfy these goals. While the White Paper is well written, it does cover many points in a rather cursory manner. It is understood that position papers were prepared which went into the various proposals in

considerable depth and which were to be distributed shortly after the White Paper. However, this was not done, and at the time of writing this brief, position papers have still not been issued. This leaves a critic of the White Paper in a most difficult position. Canadians have been asked to suggest changes and improvements to the White Paper, but they are denied many of the facts and details covering the White Paper proposals.

In order that we may discuss intelligently anything so wide-ranging in their economic, social and cultural consequences as the Proposals for Tax Reform, we ask your forebearance while we briefly describe our understanding of the setting in which the proposals must achieve the aforementioned goals.

First, we constitute a nation with enormous riches in lands, natural resources, industrial productivity, food and health as compared with most peoples of the contemporary world. For all that we are rich, by far the greatest proportion of our riches are underdeveloped or untapped. If we do not develop them for our own benefit and also for the benefit of the rest of the world, they will be taken away from us and developed by other hungrier, tougher people within a few decades. We do not live securely in a vacuum and our economics are not insular.

Second, turning to Canada internally we must ask ourselves what are the functions of our Government? After all, the purpose of taxation is to provide Government with sufficient monies to execute its functions. Bertrand Russell in his series of lectures published under the title, "Authority and the Individual" suggests that the primary aims of Government should be three: Security, Conservation and Justice. He states, "These are things of the utmost importance to human happiness, and they are things which only Government can bring about. At the same time, no one of them is absolute; each may, in some circumstances, have to be sacrificed in some degree for the sake of a greater degree of some other good". We agree with Dr. Russell and we view these three primary areas of Government concern as follows:

Security involves (1) the preservation of the state and its natural rights and properties against other alliances of men known as nations.

(2) the preservation of the rights and freedoms of individuals against other individuals and against the state. Those must be secured by due process of law, an independent judiciary and creation of an attitude of respect for individual liberties.

and (3) the provision of economic security from the gross effects of misfortune or incompetence. This involves security against an impecunious old age, against the cost of medical care, against unemployment, against the cost of education, and against great fluctuations in the economy of the state.

Conservation involves the protection and orderly development of our natural resources, and the preservation of our ecology.

Justice. In the last two hundred years the society of man has changed enormously from a serf society, where only a privileged few enjoyed health and a sufficiency of food, comfort and creative leisure time, while the majority endured deprivation, hardship and grinding labour. Our concepts of justice and fairness no longer will permit a glittering oligarchy to co-exist with a subservient improverished majority. At least we have progressed to where we will not tolerate this within the confines of a national entity. We are still prepared to accept it on an international basis. Because, in the developed western nations,

our control over nature through science and resultant technology is sufficient to allow greater productivity per man, we feel that there is no need for poverty.

This then is the social setting in which the government has put forth its Proposals for Tax Reform.

Our first area of concern centers around the question of justice, as the White Paper Proposals have a great bearing on this point.

The White Paper states that fairness in taxation implies two principles. First, it means that people in similar circumstances should carry similar shares of the tax load, and second, that people who are better off, should be expected to pay in taxes a larger share of their incomes than persons with lower incomes. It further states that "there is no simple or single rule for increasing the rax rates up the income ladder that can be said to be the 'right way'. It is a matter of opinion, of judgment". In the light of the setting described above, no one could possibly disagree with the two principles enunciated. What we must ask ourselves is whether these two principles are the only ones to be considered in determining fairness and hence, justice.

It is our opinion that there is a <u>third principle</u> implied in determining fairness in taxation. This principle is that taxpayers, corporate or individual, who put forth extra effort, or who take extra risks in their endeavours should be able to retain a fair portion of the rewards they receive.

The first two principles which are enunciated in the White Paper are both on the same side of the scales of justice. Operating alone, they move in the direction of an equal after-tax income to all workers regardless of effort or risk involved. The third principle must operate as a counter to the first two, if true justice and fairness are to prevail. It is important that this be recognized as an integral part of the principles of fairness and not merely a matter of expedience to maintain incentive. The traditional concept of justice depicts a balance or pair of scales with a weight on one side and a counterweight on the other. The White Paper philosophy does not contain a counterweight. Imbalance, and gross inequities must inevitably result.

When certain numbers of our society have practiced such virtues as thrift, perspicacity, hard work, endurance, creativity and the taking of risks, it would seem most unfair if such endeavour when successfully executed, would still

result in anything approaching equality of material benefits with others who had practiced none of these virtues.

The authors of the report of the Royal Commission on Taxation place equality in its proper perspective in their discussion of the principles of "equity". They state:

> "We are firmly convinced that this redistribution (of purchasing power) is necessary if we are to achieve greater equality of opportunity for all Canadians, and make it possible for those with little economic power to attain a decent standard of living."

and later in the same dissertation,

> "It is the effect of taxes on the well-being of people that matters."

We submit that taxation reform which operates toward equality of material benefit regardless of effort, rather than toward equality of opportunity for all, and which tends to ignore the effect of taxation on the well-being of its more energetic and creative citizens will not achieve the goals enunciated in the White Paper.

Our next area of concern relates to the degree of

centralized control and authority in our lives versus the degree of individual freedom for independent action. We have described the areas for which we believe governments should be responsible. We believe that happiness for most men can best be sought in an environment of responsible citizenship that allows for the maximum freedom of the individual to direct the course of his own life, and to be responsible for the consequences of his own actions. The function of government should be to ensure and protect that environment. This can be done by confining government control primarily to the areas of security, justice and conservation as described earlier in this submission.

We believe that the Proposals for Tax Reform will greatly increase the authority and power of the Federal Government and a limited number of large companies, with commensurate reduction in the autonomous freedom of the individual. This will occur because of the following:

1. The proposed removal of the tax incentive for small businesses will result in the formation of substantially fewer new companies than would otherwise occur. In addition, fewer of those that will be formed, or that already exist, will be able to survive. The existing large

corporations will be the beneficiaries of this loss of competition.

2. The reduction in the incentive for individuals to save will substantially reduce the ability of Canadians to save. This, combined with the very high proposed level of capital gains tax and the existing high death duties will result in a great transfer of wealth from Canadian individuals to the Canadian Government.

Since Canada will obviously be unable to achieve steady economic growth and continued prosperity without keeping this transferred wealth at work, we must assume that the Government intends to invest it on behalf of its citizens. The consequence of this will be to place more and more of the decisions as to where capital will be directed in the hands of a single, central authority. This area, which has been handled with great success by private capital, will progressively be taken over by public money with reduction of the spontaneous autonomy of individuals to act, at their own risk, to fill the needs of society as they see them. Bureaucracy will increase at the expense of autonomous democracy.

Another major concern lies in certain assumptions

underlying the proposals which we feel are not only unfounded, but also probably quite incorrect. These assumptions are that the new tax system will have only a nominal impact on the willingness and ability of Canadians to save and on the flow of foreign investment into the country. Based on these assumptions, predictions of government revenue can then be made in accordance with the new formulas contained in the proposed tax system. This approach is mathematically impeccable.

We believe, however, that calculations of future tax revenue under the new tax system, based on extrapolations of the growth obtained under the old tax system, must be viewed with grave suspicion. The architects of the White Paper have addressed themselves to how to equitably slice up the anticipated pie. We submit that, with the discouragement of Canadians from saving and with the reduction of attractiveness to foreign investment, past growth rates are meaningless in predicting future revenue. We believe, that the reduction in private capital formation and the discouragement of foreign investment will produce a far smaller tax pie for the government to slice up, and the economic effect of the tax proposals will be to produce economic recession and a great increase in unemployment. We shall thus have not only made the rich poorer, but we shall run the risk of making the poor poorer

than before, in direct contradiction of the stated goals of tax reform.

One of the amazing fiscal aspects of democracies is the fact that the greater portion of their revenues is raised by a system of voluntary compliance based on self-assessment. Each year in Canada, millions of individuals and corporations complete tax returns and file them with the Federal and Provincial Governments. By far the greater percentage of these returns are honestly and correctly prepared by Canadian citizens on a voluntary basis. Income tax cheating has never been of serious concern in Canada.

However, this voluntary compliance is based on trust and on the citizen's belief that he is paying his fair share, that others are paying their fair share and that government is spending the funds wisely. To a very great extent this has been the case in the past, but we wonder about the future. The monumental public outcry which has arisen from serious examination of the Tax Reform Proposals suggest that a substantial number of Canadians are in severe opposition to their content. From observations of history, we have learned that when people do not respect a law, it cannot be enforced. We fear, therefore, that one of the adverse consequences of enacting the proposals into law as written may be a substantial

increase in tax evasion, a breakdown in trust between the Government and the citizens and a severe increase in the costs of tax administration, assessment and collection.

The objective of developing a tax system that can and will be used by the Province is admirable, but we wonder whether it is possible in the light of present day Federal-Provincial relations. Any of the Provinces can increase their income tax beyong the rates suggested by the Federal Government, and the maximum rate can therefore be considerably higher than the 50% proclaimed in the White Paper. Unless all levels of Government show a greater willingness to tailor their spending to the realities of Canada's ability to produce wealth, and unless prior agreement with the Provinces is reached on joint tax reform, we believe that the promised maximum tax rate will never be achieved.

To recapitulate, we believe that the major consequences of implementing the Proposals for Tax Reform as they now stand are:

(1) <u>Social</u>

A. Unfairness and injustice will result by excessively penalizing the thrifty, productive and creative.

B. A substantial increase in bureaucratism and centralized control will emerge at the expense of spontaneous, autonomous democracy.

C. Many taxpayers will lose their respect for the tax system and will either emigrate to a less punitive environment or will attempt to engage in tax evasion.

(2) Economic

A. We may anticipate a serious set-back in economic growth and prosperity, with a consequent increase in unemployment and poverty.

B. The present attitude of Canadians toward saving for the future will be replaced by a compulsion to spend for immediate consumption.

Having outlined our grave concern with some of the consequences of implementation of the Tax Proposals, it is now encumbent on us to propose some alternatives. These alternatives should serve both to fulfill the aims of the Tax Reform Proposals as set forth in the preamble to the White Paper, and to eliminate the unhappy consequences which have been prophesied in the foregoing.

The White Paper represents the work of a large number of well intentioned men bringing to bear on the business of tax reform a high degree of expertise and a great deal of hard work. The proposals are comprehensive and contain many excellent aspects. We feel, however, that if they are to achieve their stated objectives, the following modifications must be adopted:

1. CAPITAL GAINS SHOULD BE TAXED SEPARATELY FROM INCOME, AND CERTAINLY WITH NO MORE SEVERE TREATMENT THAN IN THE UNITED STATES.

2. THERE SHOULD BE NO DEEMED REALIZATION OF CAPITAL GAINS UNDER ANY CIRCUMSTANCES.

3. FOREIGN CORPORATIONS DOING A SIGNIFICANT PORTION OF THEIR BUSINESS IN CANADA SHOULD BE TREATED AS WIDELY-HELD CANADIAN CORPORATIONS.

4. THE 21% TAX ON THE FIRST $35,000 OF CORPORATE TAXABLE INCOME SHOULD BE RETAINED, OR ALTERNATIVE INCENTIVES SHOULD BE PROVIDED FOR SMALL BUSINESSES TO BE FORMED AND TO GROW.

5. MEANINGFUL INCENTIVES FOR THE RISK-TAKING EXTRACTIVE INDUSTRIES SHOULD BE ENSURED.

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6. THE RIGHT SHOULD BE PROVIDED FOR ANY CANADIAN INDIVIDUAL, PARTNERSHIP OR CORPORATION TO WRITE-OFF ALL EXPENSES INCURRED IN EXPLORATION FOR PETROLEUM, NATURAL GAS OR OTHER MINERALS AGAINST ORDINARY INCOME, IN THE YEAR INCURRED.

We are sure that many other excellent suggestions will be made to the Committee relating to areas of the White Paper other than those dealt with herein. We have only made suggestions relating to those areas with which we have knowledge and concern as a result of our business dealings.

Our detailed reasons for the above recommendations follow.

TREATMENT OF CAPITAL GAINS

The Government proposes to tax capital gains at ordinary rates of income, with the exception that only one-half the gain would be taxed in the case of sales of shares of widely-held Canadian companies. The tables on Page 25 of the White Paper indicate that, immediately after implementation of the proposals, capital gains of individuals could be taxed at a rate as high as 81.92%; but after a five year transitional period this maximum rate will reduce to 51.2%. It appears that in many Provinces the maximum rate will be in excess of 51.2% and, if during the five year transitional period the revenue demands increase, then even these maximum rates will be exceeded.

Canada is a country which is short of investment capital. The high standard of living which the country has enjoyed through the last two decades and the tremendous expansion of the economy, particularly in the extractive industries, has been financed to a large extent by foreign capital. All indications are that Canada will be short of capital for the foreseeable future.

The Economic Council of Canada in its sixth annual review, which was published in September of 1969, points out on Page 93 the following:

"To achieve potential output in 1975 - that is, an

expansion of over 50% in the volume of total output from 1967 to 1975 - will require substantially increased investment in business, plant, equipment, inventories, housing and social capital. To finance this substantial growth in investment, the economy will therefore, also need to generate a very high rate of growth of savings."

The Council has estimated Canada's sources of savings as follows:

TABLE 6-3 SOURCES OF SAVINGS AS PERCENTAGE OF TOTAL REQUIREMENTS

	1964-66	1967	At Potential in 1975
	(Average)		
Personal Saving	17.9	24.4	16.9
Business Saving	72.7	68.4	74.8
Government Surplus	2.1	2.3	2.1
Non-resident Saving	7.3	4.9	6.2
Total Measured Sources of Saving . .	100.0	100.0	100.0

Source: Based on Data from Dominion Bureau of Statistics and estimates by Economic Council of Canada.

The above study shows that at least through to 1975, Canada will need all the domestic capital it can produce, as well as importing in 1975, approximately 6.2% of its capital needs.

This study is based upon the present tax laws of Canada and it does not take into account any possible change in the savings pattern of Canadians which will result from implemetation of the proposals in the White Paper. On Page 12 of the minutes of proceedings of the Standing Committee on Finance, Trade and Economic Affairs of Thursday, January 15, 1970, Mr. Benson is reported as stating:

> "The savings of the economy when the total package is in effect five years hence, if it were adopted as this package - there would be a reduction in the savings in the economy of about 4.5% or 5% of the total savings in the economy."

Presumably this reduction in savings by Canadians will have to be made up by increased foreign investment in Canada or else the rate of growth of the Canadian economy will be reduced. However, at the present time, there is a world shortage of capital.

Canada does not operate in a fiscal vacuum and its tax structure must be at least harmonious with that of its most important trading partner the United States. Appended hereto as Exhibit

"A", is a summary of the current and proposed United States capital gains treatment, which shows that for capital gains of less than $50,000 per year, the capital gains tax does not exceed 25%. Recent amendments will increase the tax rate on gains <u>in excess of $50,000 per year</u> to as much as 35% by 1972.

If Canada wishes to remain competitive in the world capital markets, we would recommend that:

> CAPITAL GAINS BE TAXED SEPARATELY FROM REGULAR INCOME; AND THAT THE RATE OF TAX SHOULD NOT BE MORE SEVERE THAN IN THE UNITED STATES.

<u>FIVE YEAR DEEMED REALIZATION</u>

In Paragraph 3.36 it is proposed that one-half of the accrued gains or losses on shares of widely-held Canadian corporations be taken into income and taxed every five years. This is one of the two exceptions to the general rule that capital gains and losses would be taxable only when they are realized.

This proposal will adversely affect King Resources Company's plans for the formation of a Canadian Company in which

Canadians would participate. There is no provision, at the present time, for the company to obtain any foreign tax credit in the United States in the event that Canada taxes the deemed profits every five years. In addition a tax on deemed realization could force the company to dispose of some of the subsidiary's shares in order to raise funds to pay this tax, thereby reducing the company's equity interest in the subsidiary. In effect, the proposal means that if the company were to form a Canadian subsidiary to operate in Canada, it could not afford to offer shares in this subsidiary to the public, because the Canadian subsidiary would be regarded as a widely-held corporation, the shares of which would require revaluation every five years.

There are already a number of corporations that are widely-held as defined by the White Paper, but which have a corporation outside of Canada owning a majority of their issued shares. Many of these companies are well known international organizations and there is no need for us to list them here. The foreign corporation which owns the majority of the shares of these Canadian companies will, of course, have to pay a capital gains tax every five years on the deemed realization. It has been Canadian Government policy over the last few years to encourage these foreign companies to offer a portion of the share capital of their subsidiaries to Canadian citizens. Having done so, is it fair to place these companies in the position where they will pay taxes to Canada which put them at a competitive disadvantage?

It should also be pointed out that there are a number of large or medium sized Canadian companies which originally started corporate life as small private companies; and during the last two decades have gone public. In most instances, the controlling shareholders of these companies (which are now widely-held Canadian companies) are the original founders of the business. If these people are forced to revalue their shareholdings every five years, they will in many instances have to sell part of their shareholdings in order to pay their income tax. In this manner they could be forced by Government tax policies to lose control of a business which they themselves have built up, with a good deal of sacrifice, toil and risk.

As noted in Paragraph 3.4 the other deemed realization would occur when a taxpayer gives up Canadian residence. Foreign executives often come to Canada for temporary periods of time to work in the Canadian operations of international organizations; and Canadian executives often transfer to other countries for temporary periods of time to work in the domestic operations of such organizations. In our opinion these temporary transfers of executives have been beneficial to the Canadian economy, in that they result in a cross-fertilization of ideas, and permit Canadian management to benefit from the experience and expertise of their foreign counterparts.

The proposal of the White Paper for the deemed realization of capital gains on change of residence will seriously restrict such temporary transfers.

Under the proposal, when a foreign executive enters Canada he will be deemed to have acquired all of his assets at their fair market value at that time. When he leaves Canada he will be deemed to have sold all of his assets at their then fair market value and he will be subject to tax on a deemed gain, regardless of where the assets are located, or where the investment was made.

Foreign executives transferring temporarily to Canada often have personal wealth which is invested in their home countries. The White Paper proposals would require them to pay a tax on the amount by which this property increased in value while they were temporarily present in Canada, even though they have not realized any actual gain and would, therefore, obtain no tax relief by way of foreign tax credits.

For the same reasons as outlined above, the White Paper proposals would result in a tax on unrealized capital gains of a Canadian executive at the time he departs from Canada, and will therefore tend to discourage Canadian executives from accepting a temporary transfer to a foreign country.

In addition to the foregoing the proposal for deemed realization seems most confiscatory to Canadians who for reasons

of health or employment opportunities may wish to live temporarily or permanently in another country or climate. Certainly an attractive social and economic climate should result in people agreeing to pay their taxes because they treasure their residence and citizenship; rather than forcing them to retain residence for fear of the tax penalties that they must suffer through emmigration. This kind of penalty against emmigration of free thinking citizens is typical of totalitarian governments. Let it not be said that the world first had an iron curtain that descended around all the Russias, a bamboo curtain around China, and now a paper curtain - a White Paper curtain around Canada.

In view of the above, and because we firmly believe that taxation on the basis of deemed realization is grossly unjust, we recommend that:

> THERE SHOULD BE NO DEEMED REALIZATION OF CAPITAL GAINS UNDER ANY CIRCUMSTANCES.

<u>TREATMENT OF FOREIGN CORPORATIONS OPERATING IN CANADA</u>

Paragraph 4.43, among other things, states that only companies incorporated in Canada would be eligible to be treated as Canadian widely-held corporations. Many companies have been

doing business in Canada as branches of foreign firms. Because of taxing restrictions in their own country they must operate in Canada as foreign corporations. In some cases these foreign corporations are conducting a major portion of their business in Canada, are listed on one of the Canadian stock exchanges, and have a fairly large body of Canadian shareholders. Under the proposals, these companies would not be classed as widely-held Canadian corporations and this would mean that full capital gains on share disposal would be taxed, as against a tax on 50% of the gain on disposal of widely-held Canadian corporation shares. In addition, under Paragraph 4.66, foreign corporations operating in Canada would not be able to pass credits for corporation tax paid back to their shareholders, as is proposed for a Canadian widely-held corporation.

The existing Canadian tax laws complicate the transfer of King Resources Company's Canadian oil, gas and mining properties to a Canadian subsidiary for the purposes of offering stock to Canadians. These complications are further aggravated by American tax problems, which would affect the company if such a Canadian subsidiary were to be organized. For these reasons, the company has considered the formation of a separate United States incorporated subsidiary to hold its Canadian assets, which subsidiary would offer stock to Canadians. This subsidiary would carry on business solely in Canada, and essentially all

of its taxes would be paid to Canada. However, because the proposals mentioned above severely detract from the attractiveness to Canadians of stock in an American-incorporated company carrying on business in Canada, it is unlikely (as the White Paper proposals now stand) that the company could form a foreign subsidiary for its Canadian operations and offer equity participation in that subsidiary to Canadians.

We would, therefore, recommend that:

> A FOREIGN CORPORATION, CONDUCTING A SIGNIFICANT PORTION OF ITS BUSINESS IN CANADA, AND LISTED ON ONE OF THE CANADIAN STOCK EXCHANGES, SHOULD BE CONSIDERED A WIDELY-HELD CANADIAN CORPORATION FOR TAX PURPOSES.

INCENTIVES FOR SMALL BUSINESSES

In Paragraph 4.30 it is proposed to eliminate, during the next five years, the special tax rate of 21% on the first $35,000 of corporate taxable income. This proposal will substantially increase the taxes to be born by existing small corporations. The mortality rate of new businesses is exceedingly high and one of the main reasons for this is the lack of

adequate capital.

In many cases small companies require outside financing, and the amount of this outside financing is nearly always related to the early earning power of the company. If earnings are going to be taxed at the full 50% rate, outside financing will be much more difficult to obtain, and many new businesses will be crippled financially and fail in their early years.

The alternative, of course, is that anyone attempting to start a business of their own will require much more capital before commencing operations than has been necessary in the past. However, the taxing of capital gains at full rates, and the increase in taxes on earned income for persons in the $9,000 and up range, will make the accumulation of capital for such purposes much more difficult than in the past. Obviously fewer new businesses will be established. Since many small businesses have within them the seed to become large businesses, and eventually widely-held Canadian corporations providing employment for large numbers of taxpayers, the foregoing effects seem to be diametrically opposed to Canada's national objectives.

The White Paper lists a number of "faults" (Paragraph 4.16 and 4.18) in the present system which are most misleading. As pointed out in Paragraph 4.17 the practice of forming a number of companies to obtain the low rate of tax on the first

$35,000 of income was eliminated long ago. The so called "faults" listed in paragraph 4.18 ignore the basic fact that a corporation is a distinct entity, created by law, and separate from its shareholders. Consequently the corporation is taxed on its income, and the shareholders are taxed when they receive dividend income. Contrary to what is implied in Paragraph 4.18 shareholders, in the vast majority of cases, are not paid dividends because the corporation lacks the working capital to make dividend payments and still carry on business. The corporate type of business enterprise is the only practical one in which to carry on a business when more than one individual is involved, because of the limited liability of the shareholders.

Certain professions (medicine, law and accountancy) cannot incorporate their operation; but must practice as individuals or partnerships. This, of course, puts these people at a tax disadvantage compared to others who can incorporate. However, viewed in total, these professions form a very small percentage of the independed businesses in Canada. All others can incorporate if they wish and obtain the needed tax relief for small businesses. If any tax changes are to be made in this regard it should be to allow those professions which cannot incorporate to have their operations treated as incorporated businesses for tax purposes.

Even though the elimination of the 21% rate on the first $35,000 of taxable income will have little direct effect on King Resources Company's finances, we nevertheless feel it has a direct bearing on our operations from another point of view. The company employees a number of sub-contractors during the course of its operations in drilling, road-building, well-servicing, seismic operations and transportation. In most cases they are hired on a competitive bid basis. Many of these companies are small operators, who provide a competitive atmosphere which tends to keep costs in line. If these small businesses are eliminated by higher taxation and lack of capital, we will be forced into a less competitive, and therefore more costly business situation.

We would, therefore, recommend that:

> THE 21% TAX ON THE FIRST $35,000 OF CORPORATE TAXABLE INCOME BE RETAINED, OR A SUITABLE ALTERNATIVE INCENTIVE BE DEVISED FOR SMALL BUSINESSES.

DEPLETION

As proposed in Paragraph 5.40 of the White Paper, the Government intends to cancel the depletion allowance for operators

of 33-1/3% of the net profits from production, and replace it with a system of "earned depletion". For every three dollars spent on eligible exploration (which is not defined) the taxpayer would earn the right to one dollar of depletion allowance. While we would agree with the criticism that the present depletion allowance is inefficient (as detailed in Paragraph 5.38 and 5.39 of the White Paper), we do not believe that earned depletion is the way to cure this inefficiency.

As we understand it, the concept of "earned depletion" as an incentive has three main inequities:

1. The proposal that a depletion credit be earned at the rate of $1.00 for every $3.00 spent on eligible exploration is not a sufficient incentive for exploration in certain remote areas of Canada, such as the Northwest Territories, Arctic Islands, Hudson Bay and East and West Coast offshore.

2. It is proposed that eligible exploration expenses will not include the cost of acquiring petroleum, natural gas and mineral rights. In the Canadian oil and gas industry, the cost of acquiring these rights may be a large portion of a company's total exploration budget.

3. There are a number of high-risk situations which do not lend themselves to continuing exploration programs; for example: silica developments, gypsum quarrying, large scale open-pit coal operations, etc. Under the concept of "earned depletion" there is very little incentive for this type of resource development, yet the national economic benefits of such activity can be substantial.

4. The five year transition period is far too short and will discriminate against those taxpayers, Canadian and foreign, who have made substantial investments in exploration in Canada in the past, unless they are at present in a taxable position, or become taxable during the five year period.

However, even if the four inequities mentioned above were eliminated, "earned depletion" would still not be as desirable a method of providing incentive as percentage depletion.

It should be pointed out that depletion under United States tax laws, which was allowed at a 27-1/2% rate, has recently been reduced by Congress to 22%. However, the rules for calculating the allowances for United States taxpayers

differ in a number of important aspects from the current or proposed Canadian rules; the principal difference being that the American depletion allowance is calculated on gross income, with a net income limitation, and net income is calculated on a lease by lease basis. As a result, depletion under United States tax laws, even at the reduced rate of 22%, will, in most instances, exceed depletion under present Canadian tax law at a rate of 33-1/3%.

It appears to us that a better incentive would be to maintain percentage depletion; but calculate the depletion allowance on gross income and not on net income, then set a maximum allowance of 33-1/3% of net income, calculated before the deduction of exploration and development costs. The rate of depletion (which is now 33-1/3%) could then be reduced to 25%. This method would overcome the objections to the present system, because exploration and development costs would be deducted after the calculation of depletion; and there would be a limitation (based on net income) of the amount that could be claimed. Also this method could be more easily administered by the Department of National Revenue.

The White Paper proposes that royalty depletion be eliminated. In the past, the dispostion of royalty interests has been used as a method of raising funds for oil exploration.

Any change in the tax laws which increases the cost of raising capital will severely affect the financing of the oil industry. We believe that royalty depletion should be continued, but on the same basis as working interest income.

We would, therefore, recommend that:

> PERCENTAGE DEPLETION BE RETAINED, BUT THAT IT BE CALCULATED ON GROSS INCOME, THE RATE BEING REDUCED TO 25%, WITH A MAXIMUM AMOUNT NOT TO EXCEED 33-1/3% OF NET INCOME, CALCULATED PRIOR TO DEDUCTING EXPLORATION AND DEVELOPMENT COSTS.

While the White Paper proposes that some form of depletion be retained as an incentive for mineral exploration, it also proposes to eliminate depletion on dividends. The benefit of "earned depletion" cannot be passed on to a company's shareholders, because there will be no creditable Canadian tax with respect to the depletion which has been claimed by the company. This loss of depletion on distributions by companies to their shareholders will further reduce the attractiveness of investments in resource companies operating in Canada. Paragraph 5.44 implies that the market price of shares of companies in the extractive industries will decrease each year as the resource is depleted. However, stock market values fluctuate for a

number of reasons which have nothing to do with resource depletion. The fact remains that dividend income, from extractive industry shares, is partly a return of capital and partly income. If it is a valid assumption, (and we believe it is) that an incentive is needed in the extractive industries, then the shareholder requires the incentive just as much as the corporation. Therefore, if the extractive industries are to continue to attract the necessary capital for development it is imperative that there be a depletion allowance on dividend income. The present allowance of 10%, 15% and 20% has been reasonable and has worked well in the past.

We would, therefore, recommend that:

THE PRESENT DEPLETION ALLOWANCE ON DIVIDEND INCOME BE RETAINED.

THREE YEAR TAX EXEMPTION FOR NEW MINES

Under Paragraph 5.31 of the White Paper it is proposed that the three year tax exemption for new mines be phased out. This provision would be replaced by a fast write-off of mine machinery and buildings.

There is no doubt that the three year tax exemption of new mines has been a great help to the mining industry in Canada. It has contributed to the development of new mining properties, the opening up of many rural areas, the creation of new jobs for Canadians, and the improvement of Canada's balance of payment position in world trade. The proposed fast depreciation write-off is merely a tax-deferment and does not compensate for the loss of the three year tax exempt period.

The Carter Royal Commission on Taxation referred to a study prepared for the Royal Commission on Banking and Finance which indicated that between 1907 and 1953 there were over 400,000 mining claims recorded in Ontario and 6,679 metal mining companies formed of which 348 went into production and only 54 paid dividends. With a risk factor such as this, it is clear that special incentives are needed, which are at least equivalent to the three year tax exempt period.

If the Committee believes that the existing incentive has, in some cases, resulted in abuses because of high-grading during the three year tax period, we would suggest (rather than eliminating the tax exempt period) that the total amount of tax free income that could be obtained during the period be limited to the total cost of bringing the mining property into production. The use of these costs, as a measure of total tax-free

income which could be obtained, should not, of course, affect the right of the corporation to deduct the cost from future income.

We would, therefore, recommend that:

THE THREE YEAR TAX EXEMPTION OF NEW MINES BE RETAINED, SUBJECT TO A TOTAL COST LIMITATION.

DEDUCTIONS BY TAXPAYERS WHO FAIL TO MEET THE "PRINCIPAL BUSINESS" TEST

Section 5.26 of the White Paper proposes that:

"Taxpayers who fail to meet the principal business test be entitled to put their future exploration and development expenses in an asset class and to deduct annually part or all of their accumulated undeducted expenses up to a maximum of the greater of two amounts:

(1) Their income from mineral properties before any deduction in respect of exploration and development expenses,

OR

(2) 20 percent of the net book value of the class. For this purpose, income from mineral properties would include producing profits, royalties received, and the proceeds of the sale of mineral rights."

To the extent that it will permit taxpayers to deduct their exploration and development expenses from their income from mineral properties, this proposal does not give any rights which are not already included in sub-section (4b) and (4c) of Section 83 (A) of the present Income Tax Act. However, the right of these taxpayers to deduct 20% of the net book value of these expenses from other income is new.

Continuing the practice of allowing taxpayers who meet the "principal business" test to deduct exploration and development expenses from their total income; and applying separate rules for taxpayers who fail to meet the "principal business" test, ensures that Canadian taxpayers and tax assessors will still be plagued with the very difficult question of determining the "principal business" of each taxpayer. This question has already been considered by the Canadian courts in several cases, with conflicting results. See: Sogemines Development Co. Ltd. vs M.N.R. 1968 Tax ABC 833; Canadian Dyno Mines Ltd. vs M.N.R.

1966 41 Tax ABC 21; Dillman Oil Properties Ltd. vs M.N.R. 1965 40 Tax ABC 17 and American Metal Co. of Canada Ltd. vs M.N.R. 1952 CTC 302.

Even the 'principal business" test presently contained in Section 83 (A) (3b) of the Canadian Income Tax Act includes companies whose principal business is far removed from the oil, gas and other mineral business. For example, companies engaged in the metal fabricating business such as steel companies and car manufacturers, could qualify under this "principal business" test. We see no logical reason for permitting these companies to deduct their drilling and exploration expenses from their other income, while restricting the rights of other Canadian taxpayers. Such a restriction unnecessarily limits Canadian capital available for investment in this industry.

In the United States individuals, and companies, are permitted to deduct exploration and development expenses, incurred anywhere in the world, from their income in computing their United States income taxes. These taxpayers do not have to meet a "principal business" test. Therefore, individuals and companies not primarily engaged in the oil and gas business may participate in exploration and development in Canada, and write these expenses off against their other income. They, therefore, have a decided advantage over Canadians wishing to

participate in exploration and development of Canadian minerals who must use after-tax dollars to do so. We believe that a large percentage of the United States investment in exploring for Canadian oil and gas is made by individuals and companies who are not principally in the oil and gas business.

We should also point out that if the White Paper proposals become law as written, without any changes, this particular section would never have to be used. Because of Paragraph 3.31, all that would be necessary for anyone who wished to explore for petroleum and natural gas would be to form a private company and issue shares for all the money that they put into the company. If the exploration venture is unsuccessful the taxpayer would merely sell his shares for $1.00 and write-off his total loss against his other income.

Under the proposals in the White Paper all proceeds from the sale of mineral interests will be taxable at ordinary rates. Drilling and exploration expenses, including costs of acquiring these properties, should therefore be deductible regardless of the "principal business" of the taxpayers.

The Royal Commission on Taxation investigated the problem of "principal business" and stated on pages 354 and 355 of Volume 4 of the following:

"Application of Mining and Petroleum Provisions to Particular Types of Taxpayers"

"Under the present legislation considerable complexity is caused by the fact that provisions for the taxation of mining and petroleum income apply to different taxpayers in different ways, primarily according to whether the taxpayer is an individual or a corporation. Many of the provisions presumably were intended as incentives available only to persons in mining and petroleum. This policy does not generally appear to be valid. It is therefore recommended that the limitations on the availability of the special provisions be removed. An incidental and important effect of this change should be to encourage wider participation by Canadians in the mining and petroleum industries.:"

We would, therefore, recommend that:

> AMOUNTS EXPENDED DURING ANY YEAR ON PETROLEUM, NATURAL GAS OR MINING EXPLORATION MAY BE WRITTEN OFF AGAINST OTHER INCOME.

COMPARISON OF CANADIAN AND UNITED STATES INDIVIDUAL INCOME TAX RATES

Paragraph 8.39 of the White Paper leaves the impression that there is not a wide discrepancy between the United States and the Canadian individual income tax rates. King Resources Company has had experience in transferring personnel from Canada to the United States, and therefore, has some knowledge of the relative rates of tax in each country.

Annexed hereto as Exhibit "B" is a study, made by the company's auditors, Arthur Andersen & Co., of the Canadian and Alberta combined individual tax rates; and of the Federal United States and State of Colorado combined individual tax rates. Alberta was used in the study because the majority of the company's Canadian employees are headquartered in that Province; and Colorado was used because the company's head office is located in that State. It will be noted from the study that the Canadian tax rates at all levels of income are substantially higher than those in the United States.

It is our understanding that, in the past, a large number of Canadian university graduates (both those who have been educated in Canadian universities and those who have received undergraduate and postgraduate education in the United States' universities) have sought employment in the

United States rather than in Canada. This emigration of highly trained people represents a considerable loss to Canada. The proposals in the White Paper will, if anything, increase this trend. In addition, the recent tax changes in the United States have further reduced the rate of United States taxation in the middle and higher income brackets.

While our company is controlled in the United States, we are naturally anxious to retain Canadian personnel who are as highly qualified as possible. We are, therefore, greatly interested in having Canada adopt tax rates which will reduce, rather than widen, the gap between Canadian and American rates.

Canada is one of the most favoured lands in the western world with a future as bright as any nation. We have attempted above to ennumerate some of the things which we feel will help the accumulation of capital, encourage and reward risk taking and assist in the expansion of the economy, so that Canada can reach the full potential and standard of living of which it is capable.

All of which is respectfully submitted.

UNITED STATES CAPITAL GAINS

Capital gain and loss provisions apply to the sale or exchange of capital assets held over six months. Such gains and losses are "long term" in contrast to gains and losses on capital assets held six months or less which are "short term" gains and losses.

For each taxable year the "short term" and "long term" transactions are separated and the net gain or loss is determined for each class. If there is a gain in one class and a loss in the other, the two classes are combined to determine the "net long term" or "short term" capital gain or loss. Net short term gains are taxed in full as ordinary income.

Net long term gains are reduced by 50% and taxed as ordinary income, but at a maximum rate of 25% on the first \$50,000 of such gains; and at a maximum rate of 29½% on the gain over \$50,000. In 1971 the 29½% rate for gains in excess of \$50,000 increases to 32.5%, and in 1972 it increases to 35%. "Net long term" gains are the excess of "long term" gains over "long term losses" and net "short term" losses.

Net capital losses can be offset up to \$1,000 in ordinary income each year. However, only 50% of the net long term capital loss is taken into consideration for this purpose.

EXHIBIT A

Thus, $2,000 of <u>long</u> term losses are necessary to produce a $1,000 deduction. Such losses in excess of the deduction allowed against ordinary income are carried forward to the following years, and entered in the computation of net gains and losses. The 50% of long term capital losses that is disallowed may not be carried over.

EXHIBIT B(1)

COMPARISON OF UNITED STATES AND CANADIAN PERSONAL INCOME TAXES

A. Under Income Tax Law in effect for 1969:

	TAXES		
Gross Income	Denver Colorado	Calgary Alberta	% That Canadian Tax Higher Than U.S. Tax
10,000	1,456	1,666	14%
15,000	2,601	3,346	29%
20,000	3,844	5,572	45%
30,000	7,015	10,436	49%

B. Under United States Tax Law after full implementation of the Tax Reform Act of 1969 and under Canadian tax rules after full implementation of the White Paper Proposals for Tax Reform:

	TAXES		
Gross Income	Denver Colorado	Calgary Alberta	% That Canadian Tax Higher Than U.S. Tax
10,000	1,252	1,714	37%
15,000	2,297	3,590	56%
20,000	3,440	5,725	66%
30,000	6,339	10,634	68%

EXHIBIT B(2)

TAXES INCLUDED IN PREVIOUS CALCULATIONS:

1. Resident of Calgary, Alberta:

   A. Canadian Federal Income Tax.

   B. Province of Alberta Income Tax.

   C. Canada Pension Plan.

   D. Minus Family Allowance Payment received.

2. Resident of Denver, Colorado:

   A. United States Federal Income Tax.

   B. State of Colorado Income Tax.

   C. Tax under the Federal Insurance Contributions Act. (Social Security Tax).

EXHIBIT B(3)

SUMMARY OF ASSUMPTIONS IN CANADIAN DOLLARS

	Individual A	Individual B	Individual C	Individual D
BASIC ASSUMPTIONS				
Income - Salary	$10,000	$15,000	$20,000	$30,000
Property taxes on house	400	500	700	900
Interest on house mortgage	1,000	1,200	1.600	2,000
Interest and finance charges on charge accounts	100	100	100	100
Married	Yes	Yes	Yes	Yes
Wife's income	Nil	Nil	Nil	Nil
Children (age 6 and 12)	2	2	2	2
Charitable contributions	25	50	75	100
Medical insurance premiums	150	150	150	150
Medical expenses paid by insurance company on behalf of taxpayer	200	200	200	200
Uninsured medical expenses paid direct by taxpayer	100	100	100	100
Tax return preparation fee	25	25	25	25

ADDITIONAL ASSUMPTIONS - CASE I

Each of the above taxpayers is resident in Calgary, Alberta

EXHIBIT B(3)

ADDITIONAL ASSUMPTIONS - CASE II	Individual A	Individual B	Individual C	Individual D
Each of the above taxpayers is resident in Denver, Colorado.				
State gasoline tax (assume non business mileage of 10,000) per "State Gasoline Tax Table".	57	57	57	57
State sales tax per "Optional State Sales Tax Tables:.	134	163	195	233
City of Denver sales tax (75% of State Sales Tax)	101	122	149	178

APPENDIX "G"

NAME: KING RESOURCES COMPANY AND ITS CANADIAN EMPLOYEES

SUBJECT: White Paper Proposals

Analysis of Appendix "F" by Senior Advisor.

This Brief is submitted by senior employees of King Resources Company on behalf of themselves and on behalf of the Canadian Division of King Resources Company.

King Resources Company is an independent resource development company, incorporated in the United States and operating in the United States, Canada, the Middle East, South Africa, the Caribbean and in other areas of the world. The company commenced operating as a branch in Canada in 1962 and owns petroleum, natural gas and other mineral rights in Ontario, Manitoba, Saskatchewan, Alberta, British Columbia, the Northwest Territories and the Arctic Islands.

The first 16 pages of the Brief deals with the social and economic consequences which may result from the proposals, these are recapitulated on pages 15 and 16 as Social:

A. Unfairness and injustice will result by excessively penalizing the thrifty, productive and creative.

B. A substantial increase in bureaucratism and centralized control will emerge at the expense of spontaneous, autonomous democracy.

C. Many taxpayers will lose their respect for the tax system and will either emigrate to a less punitive environment or will attempt to engage in tax evasion.

Economic

A. We may anticipate a serious set-back in economic growth and prosperity, with a consequent increase in unemployment and poverty.

B. The present attitude of Canadians toward saving for the future will be replaced by a compulsion to spend for immediate consumption.

The Brief makes a number of suggestions as follows:

1. "CAPITAL GAINS SHOULD BE TAXED SEPARATELY FROM INCOME, AND CERTAINLY WITH NO MORE SEVERE TREATMENT THAN IN THE UNITED STATES.
2. THERE SHOULD BE NO DEEMED REALIZATION OF CAPITAL GAINS UNDER ANY CIRCUMSTANCES.
3. FOREIGN CORPORATIONS DOING A SIGNIFICANT PORTION OF THEIR BUSINESS IN CANADA SHOULD BE TREATED AS WIDE-HELD CANADIAN CORPORATIONS.
4. THE 21% TAX ON THE FIRST $35,000 OF CORPORATE TAXABLE INCOME SHOULD BE RETAINED, OR ALTERNATIVE INCENTIVES SHOULD BE PROVIDED FOR SMALL BUSINESSES TO BE FORMED AND TO GROW.
5. MEANINGFUL INCENTIVES FOR THE RISK-TAKING EXTRACTIVE INDUSTRIES SHOULD BE ENSURED.
6. THE RIGHT SHOULD BE PROVIDED FOR ANY CANADIAN INDIVIDUAL, PARTNERSHIP OR CORPORATION TO WRITE-OFF ALL EXPENSES INCURRED IN EXPLORATION FOR PETROLEUM, NATURAL GAS OR OTHER MINERALS AGAINST ORDINARY INCOME, IN THE YEAR INCURRED." (Pages 17 and 18 of the Brief).

On pages 19 to 26, the Brief sets out the reasons why it believes capital gains should be taxed separately from income and why there should be no deemed realization of capital gains.

On pages 26 to 28, the Brief sets out the reasons for the suggestion that foreign companies under specified circumstances should be treated as widely held Canadian corporations.

On pages 28 to 31, the Brief states its position for the retention of the low rate of tax on the first $35,000 of taxable income.

On pages 31 to 38, the Brief deals with its suggestion that meaningful incentives for the risk taking extractive industries

should be ensured. These are divided into:

(1) Depletion - operator.

The Brief suggests that percentage depletion based on gross income with a limit in relation to net income would be a better incentive, and that this depletion should apply to both production and royalty income. (Page 35 of the Brief).

(2) Depletion - shareholder.

The Brief recommends that the present depletion allowance on dividend income be retained. (Page 36 of the Brief).

(3) Three year tax exemption for new mines.

The Brief recommends that the three year tax exemption of new mines be retained, subject to a total cost limitation. (Page 38 of the Brief).

On pages 38 to 42 the Brief deals with deductions for exploration and other expenses incurred by taxpayers who fail to meet the "principal business" test.

The brief points out that all taxpayers irrespective of their principal business should be permitted to deduct from income amounts expended on petroleum, natural gas or mining exploration.

The attention of the Committee is drawn to the following remarks:

(1) We believe that calculations of future revenue under the new tax system, based on extrapolations of the growth obtained under the old tax system, must be viewed with grave suspicion. (Page 13 of the Report).

(2) From observations of history, we have learned that when people do not respect a law, it cannot be inforced. We fear, therefore, that one of the adverse consequences of enacting the proposals into law as written maybe a substantial increase in tax evasion, a break-down in trust between the Government and the citizens and a severe increase in the costs of tax administration, assessment and collection. (Pages 14 and 15 of the Brief).

(3) "Certainly an attractive social and economic climate should result in people agreeing to pay their taxes because they treasure their residence and citizenship; rather than forcing them to retain residence for fear of the tax penalties that they must suffer through emmigration. This kind of penalty against emmigration of free thinking citizens is typical of totalitarian governments. Let it not be said that the world first had an iron curtain that descended around all the Russias, a bamboo curtain around China, and now a paper curtain - a White Paper curtain around Canada." (Page 26 of the Brief).

(4) If it is a valid assumption, (and we believe it is) that an incentive is needed in the extractive industries, then the shareholder requires the incentive just as much as the corporation. (Page 36 of the Brief).

The brief does not lend itself to the preparation of the usual summary of present law, White Paper proposals and principal points of Brief.

APPENDIX "H"

JAMES RICHARDSON & SONS, LIMITED

ESTABLISHED 1857

RICHARDSON BUILDING, ONE LOMBARD PLACE, WINNIPEG 2, CANADA (204) 988-5811

OFFICE OF THE PRESIDENT

May 20, 1970.

Honourable Salter A. Hayden,
Chairman,
Standing Senate Committee on
Banking, Trade and Commerce,
Senate of Canada,
Ottawa, Ontario.

Dear Senator Hayden,

I would like to express our appreciation of the very cordial manner in which our Brief was received in your Committee on May 7th. We particularly enjoyed the manner in which the question period developed and the general atmosphere which permitted a free and easy exchange of ideas.

Near the completion of the hearing Senator Phillips asked our view on whether or not the economy of the country was being affected during the period of debate in respect to the White Paper. While I believe we stated quite definitely that in our opinion there was a very serious detrimental effect during the period of uncertainty, we perhaps did not stress this view strongly enough. We could document several rather important potential developments which we know are being deferred but unfortunately the really important ones cannot be publicized at the moment.

As part of this discussion Senator Phillips raised the question as to what might be done to remove some of the uncertainty which undoubtedly is far more detrimental than many people appreciate. In the attached memorandum we have attempted to provide a more definite answer to Senator Phillips' questions and subject to your approval, we would like to have the memorandum brought to his attention and added to the proceedings of May 7th.

Yours very truly,

George T. Richardson

George T. Richardson,
President.

In answer to questions raised by Senator Phillips, we endeavoured to establish our concern regarding the serious detrimental effect to the business community during the period that the White Paper proposals were being debated. We would like to emphasize that this gives our firm very real concern and we think the Government of Canada should remove some of these uncertainties.

From the point of view of economic environment, it appears desirable to remove the most pressing problems as they affect business decision. The problem is to accomplish this purpose without destroying the very valuable process which is taking place within the Parliamentary Committees assisted by the contributions of concerned citizens. The implications of the integration proposals are so arbitrary and destructive and create such massive problems that some other method must be found in attempting to achieve the objectives of the White Paper. Abandonment of the integration proposals and some minimum assurances, more realistic than those in the White Paper, respecting the extractive industries and, in particular, mining, should clear the air meantime. If your Committee could agree on the substance of the integration question and upon appropriate mineral incentives, an interim report to that effect might enable the Government to reduce business uncertainties. Your Committee probably would find it easier to recommend abandonment of integration than to determine what minimum assurances are necessary for the extractive industries but it seems to us that both should have high priority.

Your Committee has heard a number of valuable briefs as they affect the extractive industries and you might be able to reach a conclusion as to what incentives, if any, are desirable. We believe that the international dependence of the mining industry for capital and markets requires a different tax treatment from other industries . A provision for depletion is an effective and simple method of reducing the corporate tax burden without establishing separate industry tax rates. In considering the merit of the present tax free period, it might be considered advisable to limit the tax free period to three years or until some fixed percentage of the capital cost is recovered, whichever is the sooner.

The Government could, at the same time, defer the capital gains provisions (if any), particularly the five year revaluation proposal and defer the institution of the proposed personal rate schedules and personal exemptions until the Parliamentary Committees can report and the provinces have made

their views known on these questions. With the abandonment of the integration proposal, it would be practical to continue fiscal incentives to defined small business until the Parliamentary Committees have made recommendations as to the manner in which best to provide realistic assistance to small business.

We put forward the foregoing as a suggestion which might resolve some of the immediate uncertainties without abandoning, or appearing to abandon, tax reform or the procedure of public involvement, both of which appear to us to be very valuable.

Queen's Printer for Canada, Ottawa, 1970

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 29

WEDNESDAY, JUNE 3rd, 1970

Twenty-Third Proceedings on the Government White Paper, entitled:
"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 29:5)

APPENDICES:

"A"—Statement from the National Foreign Trade Council, New York, N.Y.
"B"—Analysis of Appendix "A" by Senior Advisor.
"C"—Brief from the Association of International Business Corporations.
"D"—Statement of Mortimer M. Caplin, (Caplin & Drysdale, Attorneys, Washington, D.C.)
"E"—Brief from the Canadian Export Association.
"F"—Brief from Alcan Aluminium Limited.
"G"—Brief from the Investment Dealers' Association of Canada.
"H"—Analysis of Appendix "G" by Senior Advisor.
"I"—Brief from Union Carbide Corporation, (United States).

22189—1

THE STANDING SENATE COMMITTEE

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird
Aseltine
Beaubien
Benidickson
Blois
Burchill
Carter
Choquette
Connolly (*Ottawa West*)
Cook
Croll
Desruisseaux
Everett
Gélinas
Giguère
Grosart
Haig
Hayden
Hays
Hollett
Isnor
Kinley
Lang
Macnaughton
Molson
Phillips (*Rigaud*)
Walker
Welch
White
Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

22189—1½

MINUTES OF PROCEEDINGS

WEDNESDAY, June 3rd, 1970.
(45)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Benidickson, Blois, Carter, Cook, Desruisseaux, Gélinas, Haig, Hays, Hollett, Isnor, Kinley, Macnaughton, Molson and Phillips (*Rigaud*)—(17).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor; R. Breton, Executive-Secretary.

WITNESSES:

NATIONAL FOREIGN TRADE COUNCIL

Mr. R. T. Scott, Vice President.

ASSOCIATION OF INTERNATIONAL BUSINESS CORPORATION

Mr. J. Ellis, General Tax Manager, Massey-Ferguson Limited;
Mr. J. L. Bruhl, Secretary, Hunter Douglas Limited;
Mr. N. Phillips, Q.C., Counselor;
Mr. M. Caplan, Consultant, (Washington, D.C.);
Mr. Stanford G. Ross, Consultant, (Washington, D.C.).

CANADIAN EXPORT ASSOCIATION

Mr. J. M. McAvity, President;
Mr. D. M. Bailis, Member of Committee on Taxation;
Mr. J. P. Bruhl, Member of Committee on Taxation;
Mr. D. B. Craig, Member of Committee on Taxation;
Mr. M. Ellis, Member of Committee on Taxation;
Mr. G. J. Kenna, Member of Committee on Taxation;
Mr. J. G. Lees, Member of Committee on Taxation.

At 12:40 p.m. the Committee adjourned.

AFTERNOON SITTING

2:15 p.m.
(46)

At 2:15 p.m. the Committee *resumed.*

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Benidickson, Blois, Carter, Cook, Desruisseaux, Everett, Flynn, Gélinas, Haig, Hays, Hollett, Isnor, Kinley, Molson, Phillips (*Rigaud*) and Willis—(19).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor; R. Breton, Executive Secretary.

WITNESSES:

ALCAN ALUMINIUM LIMITED

Mr. P. Leman, Executive Vice President, Smelting; and President, Aluminum Company of Canada Ltd.;
Mr. J. G. Lees, Vice President and Tax Officer, Alcan Finances Ltd.;
Mr. J. A. Collins, Vice President and Economist, Alcan Finances Ltd.;
Mr. L. H. Place, Q.C., Secretary, Alcan Fiduciaries Ltd., with responsibility for personal benefits.

INVESTMENT DEALERS' ASSOCIATION OF CANADA

Mr. J. S. Dinnick, President and President of McLeod, Young, Weir & Co. Ltd., Toronto;
Hon. E. C. Manning, Edmonton;
Mr. M. D. Cox, Chief Economist, Bell Gouinlock & Co. Ltd., Toronto;
Mr. C. B. Mitchell, Thorne, Gunn, Helliwell & Christenson, Toronto;
Mr. W. E. Thomson, First Vice-President and President of Pemberton Securities Ltd., Vancouver;
Mr. J. F. Van Duzer, Director, Mills, Spence & Co. Ltd., Toronto;
Mr. H. L. Gassard, Managing Director of the Association.

Ordered: That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Statement from the National Foreign Trade Council, New York, N.Y.

B—Analysis of Appendix "A" by Senior Advisor.

C—Brief from the Association of International Business Corporations.

D—Statement of Mortimer M. Caplin, (Caplin & Drysdale, Attorneys, Washington, D.C.)

E—Brief from the Canadian Export Association.

F—Brief from Alcan Aluminium Limited.

G—Brief from the Investment Dealers' Association of Canada.

H—Analysis of Appendix "G" by Senior Advisor.

I—Brief from Union Carbide Corporation. (United States).

At 4:45 p.m. the Committee continued *in camera* until 5:30 p.m. at which time it adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

ERRATUM: In the evidence of Issue No. 19, dated Wednesday, April 29th, 1970, the remarks attributed to Mr. R. Holzkaenper, Managing Director of the Canadian Potash Producers Association,
should have been attributed to:
Mr. V. C. Wansbrough, Executive Director of the Association.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Wednesday, June 3, 1970.

The Standing Senate Committee on Banking, Trade and Commerce met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform."

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have five submissions today, and we propose to take the National Foreign Trade Council first. Mr. R. T. Scott, Vice-President of the National Foreign Trade Council of New York, is proposing to make an opening statement, and then we will follow the usual procedure of questioning.

Mr. R. T. Scott, Vice-President, National Foreign Trade Council: Thank you, Mr. Chairman. Mr. Chairman and honourable senators, my name is Robert T. Scott. I am Vice-President of the National Foreign Trade Council.

At the outset I would like to thank the members of the committee, on behalf of the Council, for affording us the opportunity of appearing before you and presenting testimony with respect to the White Paper proposals. In addition, appearance before this distinguished committee is a great personal privilege for me, for which I am deeply grateful.

Organized in 1914 to promote American foreign trade investment, the Council is a private, non-profit organization composed of over 600 United States companies. The membership of the Council includes a broad cross-section of U.S. companies doing business in all major fields of international trade and investment, including industrial corporations, commercial banks, insurance companies and firms engaged in transportation and communication.

As an organization incorporated in another country, the Council is fully aware of the honour extended to it to appear before this committee and of the responsibilities this entails. The Council will therefore make no comment upon those proposals of the White Paper which would only affect Canadians. Rather, our brief, copies of which you have before you, attempts to analyze, from the standpoint of the U.S. corporate investor, those provisions of the White Paper which, if enacted, would have serious repercussions on such investor.

As this committee knows, there is a critical scarcity of capital in the world today. Competing investment opportunities at home and abroad far exceed the supply of capital available to make such investments. Under these conditions, management decisions of a typical U.S. investor to invest at home or in one of several competing capital-importing countries must be predicated upon a variety of factors, one of which is the combined U.S. and foreign income tax effects of a given investment. In this regard, considerations of international double taxation, where a national of one country receives income from abroad which is subject to tax both in the country of nationality and the country of source, are of prime importance.

Analysis of the White Paper in the light of U.S. tax principles governing the U.S. investor leads the Council to the conclusion that enactment of the White Paper proposals enumerated in the Council's brief could create serious problems of double taxation for the U.S. investor and, to this extent, could affect decisions on the part of the U.S. investor to make, maintain or increase Canadian investment.

In addition, the White Paper could present serious problems upon renegotiation of the U.S.-Canada income tax treaty. In its more recent treaties with developed countries, the United States has espoused the free flow of investment funds between treaty countries. Thus, the United States has renounced the force of attraction principle by both treaty and statute, and in its treaties with developed countries is prepared to grant an exemption from withholding at source, on a reciprocal

basis, for interest and royalties, and is further prepared to reduce the rate of withholding on intercorporate dividends to 5 per cent. Such U.S. treaties typically provide for a reciprocal exemption at source for capital gains. Moreover, the United States takes the position that for treaty purposes the income tax system of a treaty state should not discriminate against investments in one state by residents of the other contracting state. At the same time, the United States strives for neutrality with respect to the taxation by one contracting state of its citizens and residents who desire to invest abroad.

The White Paper's imposition of tax on realized capital gains, apparently at ordinary income rates, along with the taxation of deemed realized gains upon a United States citizen's departure from Canada, and with respect to shares in widely-held corporations, would create the most severe tax problems for United States investors affected thereby, absent effective treaty relief.

If, as the White Paper clearly states, the integration proposals are in effect a prepayment of the shareholder's tax, there would appear to be a discrimination against the United States investor. Since the integration proposals will not apply to non-resident shareholders of Canadian companies, the effect of integration would seem to be that a Canadian corporation owned by Canadians is taxed at a lower rate than a similar corporation owned by United States investors.

Moreover, the continued taxation of stock dividends, the so-called thin capitalization proposals, and the proposed White Paper withholding rates on investment income, would create potential international double taxation situations for the United States investor.

Again, Mr. Chairman, the Council appreciates the opportunity to present its brief to the committee, and hopes that it will be of some assistance in the committee's deliberations on the White Paper.

Senator Phillips (Rigaud): Aside from the development of your thoughts on the capital gains tax on deemed to be realizations, which, of course, will be developed in a little more detail shortly, are there any outstanding aspects of the White Paper that are troublesome to you as investors in Canada?

Mr. Scott: Well, sir, certainly the proposed treaty withholding rates would create a great problem for the United States investor.

The Chairman: Do you mean the 15 per cent?

Mr. Scott: Yes, the 15 per cent.

Senator Phillips (Rigaud): How many of the members of your association complied with government policy announced some time ago, and allowed some of the shares of wholly-owned subsidiaries in Canada to be sold to the Canadian public, thereby creating the category of widely-held companies?

Mr. Scott: I could not give you a specific number, senator. You probably know that better than I do. We represent, of course, most, if not all, of the larger companies. This presents a particular discrimination, it seems to me, because companies otherwise similarly situated, in so far as the United States is concerned, would be taxed at a vastly different rate and in a vastly different way; with the United States widely-held subsidiary, incurring Canadian taxes which would virtually never be creditable under the United States system.

Senator Phillips (Rigaud): That is the one that impresses me most, and I was considering a concern like Union Carbide Company which sold over 25 per cent of its shares to the public and which now finds itself in the class of the so-called widely-held companies, and also finds itself in a very difficult position from the point of view of tax credits.

The Chairman: I have here a brief from the Union Carbide Corporation—that is, the United States corporation—that was filed with us some time ago, and in which they raise this point. I intended to propose that we make this part of the proceedings of today.

Senator Molson: I so move, Mr. Chairman.

Mr. Scott: Union Carbide is a company, and Jersey Standard is another. I am sure there are many more. It seems to me that the Ford Motor Company might be a widely-held corporation—either Ford or GM. The subsidiaries of these companies would be otherwise similarly situated but would bear a vastly different rate of U.S. tax.

The Chairman: You seem to make a pronouncement that on deemed realization that would not reduce the kind of tax that would be a creditable tax for United States purposes.

Mr. Scott: Actually, we take the position that even if this were otherwise a creditable

tax—I have not found any instance of where a deemed realized tax was decided upon by our revenue service to constitute a creditable tax—still as a practical matter, because of the computation of our limitation on the foreign tax credit, it is doubtful that the deemed realized tax would ever be creditable.

The Chairman: This is quite apart from the effect of the impact that that would have on the company concerned.

Mr. Scott: I do not think I get your point.

The Chairman: If you take the illustration that Senator Phillips was talking about, where you have 75 per cent of the shares of the Canadian company held by a United States company, and there is suddenly a five-year period that comes along and there is a deemed realization, then they have to find the money to pay the tax.

Mr. Scott: There is no question about it. As a matter of fact, I think that probably Union Carbide is a good example of the tax that would apply. For example, I am sure that when they made their investment the market was considerably higher than it is today. Assume valuation day was today—Let us say that they bought it at 100 and on valuation day it is 50, and five years from now it goes up to 100 again. At least from the point of view of the U.S. investor that has really not been a realized gain. His cost basis is 100 and the market value is 100. But, here we would be paying a tax which we would never recoup under the U.S. system. In fact, we would be paying a tax where there has been no real economic gain insofar as we would be concerned.

The Chairman: Senator Phillips, I am looking at page 3 of the Union Carbide brief where there are these rather significant words. They are discussing this deemed realization, and they say:

> However, UCC holds 7,500,000 shares of UCCL. If we assume an increase in price for these shares per year between valuation and revaluation date of $1.00 per year, the deemed realization or gain would amount to five times 7,500,000 shares or $37,500,000.00 and the tax exposure in relation thereto would be $9,375,-000.00. The burden of finding this amount of tax money would be well nigh impossible under market conditions as we know them.

Senator Phillips (Rigaud): I would say that even in terms of a weaker U.S. dollar to the Canadian dollar, that is still an appreciable sum.

The Chairman: Yes.

Mr. Scott: There is another point that could be made at this juncture. Certainly, U.S. Union Carbide, assuming for example, that there was a market in the United States, would not want to sell those shares in the United States because under our system this would generate U.S. source income which would militate against utilizing the foreign tax credit. This is due to the peculiarities of our foreign tax credit limitation. So, even if there were a market for these shares in the United States, the U.S. corporation presumably would never sell the shares in the United States. It would want to get foreign source income. If it sold the shares, assuming there was a market, outside of Canada in a third country for the purpose of getting foreign source income, it would appear that the White Paper seems to contemplate a source of income rule which would tax the gain in Canada. It would be a rather impossible situation.

The Chairman: In your study of the taxation systems in different countries have you found any one where there is this principle of deemed realization?

Mr. Scott: No, sir, I do not know of any other country that has this principle. That is not to say that there might not be one. I am just not familiar with such a tax.

Senator Phillips (Rigaud): Mr. Scott, are the views expressed in this paper based on your study, or do they reflect the reactions of a considerable number of your membership who have interests in Canada?

Mr. Scott: No sir, these views are not my own views at all. While I would agree with such views, in essence they represent the views of the National Foreign Trade Council and reflect the considered judgment of the larger U.S. companies with investments in Canada.

Senator Phillips (Rigaud): Would you express an overall figure of the original amount of investments that your constituent members have at stake in this country?

Mr. Scott: No sir, I do not have any figures with respect to that.

Senator Phillips (Rigaud): But they do represent the leading companies in the United States who have interests in Canada?

Mr. Scott: Yes, sir.

Senator Beaubien: Could we have a list of those companies?

Mr. Scott: We have over 600 members. Perhaps I could satisfy you by saying that of the top 100 industrial companies in the United States 85 per cent are members of the Council.

Further, 90 per cent of the 50 largest commercial banks in the U.S. are members of the Council. However, I do not have a list of members available.

Senator Phillips (Rigaud): Is it your view that even the mere publication of the White Paper for some time past has had some bearing on the slowing down of American investment in this country?

Would such retardation be aggravated if the White Paper were implemented in respect of the points affecting your companies?

Mr. Scott: I cannot say whether the publication of the White Paper has retarded investment that would otherwise have been made.

We point out in the brief that the tax factors are merely one of several important aspects that must be considered in making any foreign investment.

If the White Paper were enacted I am sure it would have a depressing effect on the flow of American investment. I do not think anyone, certainly not I, can say to what extent.

Senator Phillips (Rigaud): Would you regard the extent of the retardation if the White Paper were implemented as being significant?

Mr. Scott: Yes sir, I think so. As we point out in our brief, there would just be no possible way that we could absorb the increased Canadian taxes that would result.

Everything being equal, if a company had an opportunity to invest in Australia for instance, which has the same language and basically the same cultural heritage as the U.S. and Canada, but where the Australian taxes could be absorbed, I should expect that there would be a serious push to go to that country.

The Chairman: There is the practical difficulty, of course, that the businesses and operations are located here. You just cannot put them in your pocket and move.

Mr. Scott: There is no question about that. That is why we stress in our brief that the tax aspects are merely one of many factors which have to be analysed. The proximity of the Canadian market is, of course, a significant factor. Nevertheless, the effects of the White Paper on the U.S. investor in many cases would be overwhelming.

The Chairman: I suppose location for export is another factor.

Mr. Scott: There is no question about that.

The Chairman: At the bottom of page 3 of your brief, under the heading "Branch Profits" you state:

> Branch Profits would be subject to reduced treaty withholding tax rates similar to that applicable to dividends.

Would you care to develop that?

Mr. Scott: I suppose our only point is that the tax would go down to 15 per cent.

The Chairman: That is the tax now.

Mr. Scott: It was unclear to us what would happen upon implementation of the White Paper. If it did go up to 25 per cent, we would hope that it would come down again.

The Chairman: Do you mean as a result of the treaty?

Mr. Scott: Yes. We would go a step further. This is more fully set forth on page 18 of the brief. The paragraph you refer to is merely a capsule.

Senator Phillips (Rigaud): I do not think you are referring to branch profits in respect of branches that do not have an industrial establishment in Canada under the terms of our present treaty, pursuant to which such branch profits are subject to Canadian tax rates.

Mr. Scott: My understanding is that there would be an additional withholding on the profits of a branch coming out.

Senator Phillips (Rigaud): You are referring to when you move the profits?

Mr. Scott: Yes. We are not referring to a permanent establishment, which would attract the full Canadian rate.

Senator Phillips (Rigaud): Your brief contains reference to the subject matter of key employees and technical staff who come to Canada and are affected by the capital gains tax on leaving the country.

How serious a matter would that be for your constituent membership?

Mr. Scott: That would be a crushing burden on any U.S. citizen with any substantial degree of assets.

Of course, the problem is basically the same as that faced by the U.S. investor with a widely-held corporation. However, it is much more acute, because there would be virtually no way that a U.S. individual would be able to absorb the deemed realized Canadian tax. A corporation might conceivably absorb some of such tax. It would be very difficult, if not impossible, for the U.S. citizen to do so.

As a result, as I understand the White Paper, if someone came to Canada with various deferred compensation arrangements in the United States, with a home, stocks, and what have you, he would have to value this along with his chinaware and furniture and pay a tax on this when he left, even though most of these assets stayed in the United States.

That would be an overwhelming burden. Canada would present a most unattractive assignment for any U.S. citizen coming here on a temporary basis.

The Chairman: I would assume that as a U.S. citizen he would still have to file income tax returns in the U.S.

Mr. Scott: Yes, the United States taxes its citizens and domestic corporations on worldwide income. Therefore there would be the ordinary U.S. tax, plus the Canadian tax on the deemed realized gain, which as a practical matter would never be creditable against U.S. tax.

Senator Phillips (Rigaud): I am glad you referred again to that point because I am more accustomed to the application of the tax having regard to residence, rather than your system of nationality.

Mr. Scott: Our system is based on citizenship and we would tax our citizens on their world-wide income.

Senator Phillips (Rigaud): So you have the magnet of income tax liability resulting from income from all sources anywhere in the world.

Mr. Scott: That is correct, sir. Assume we have $100 of United States tax—we are talking about the United States citizen who is returning from Canada back to the United States—and $100 of Canadian tax. There would not be any Canadian source income under our limitation formula, so the United States citizen would pay $200 in tax, he would be out of pocket $200 rather than $100. In other words, the Canadian tax could not be absorbed against the United States tax since there is no realized income under U.S. concepts.

The Chairman: What about personal earnings of a United States citizen in Canada. They are not subject to tax in the United States?

Mr. Scott: We have a statutory exclusion. Section 911 provides for a $25,000 exclusion from gross income for a bona fide resident of Canada, or a $20,000 exclusion for a bona fide resident present in Canada for 510 days. That income would be exempt from United States tax. Anything over and above that would be taxable.

The Chairman: Regardless of the tax paid in Canada?

Mr. Scott: U.S. tax on income over and above the section 911 exemption could offset the Canadian tax against that income.

Senator Phillips (Rigaud): We see the difficulties. Having seen the difficulties, you take the position that the solution to the problem is that with respect to the movement of interest and dividends from Canadian companies the present withholding tax rate should apply, and that with respect to the capital gains tax residents of the United States should be protected, as they presently are by treaty, even though such United States national at a given moment would be a resident of Canada for a period, and even though during such tenure or a period of residence such United States national were to make a capital gain in respect of the acquisition and disposition of a Canadian capital asset? I am just wondering how far you think you should be isolated from our proposed tax structure.

Mr. Scott: As you know, the existing United States-Canadian treaty was executed in, I think, 1941, or somewhere in that era. Since then the United States has considerably refined its income tax treaty thinking. When the treaty is re-negotiated the United States would opt for the format that exists in the

French treaty. We would say a United States citizen should not be taxed in France, say, on capital gains unless he had a permanent establishment in France.

Senator Phillips (Rigaud): That is a different matter.

Mr. Scott: To which this is attractive. Otherwise, no. You inquired of a United States citizen who is a resident of Canada.

Senator Phillips (Rigaud): And acquired a capital asset situate in Canada and disposed of it during the period of tenure in Canada.

Mr. Scott: I missed the question. I assume that should be a taxable transaction.

Senator Phillips (Rigaud): It should be taxable?

Mr. Scott: Yes. In the United States, if the situation were reversed we would consider that a taxable transaction; if there is a bona fide resident in the United States we would certainly tax him on United States income, so if he had a U.S. source capital gain the United States would tax that.

Senator Phillips (Rigaud): I was wondering whether the isolation of our system in relationship to the United States residents should also cover the situation to which I referred.

Mr. Scott: No, I do not think so. Going back to treaty parlance, if a company had a permanent establishment in Canada, certainly that...

Senator Phillips (Rigaud): It is then for tax purposes deemed to be a residence, so we have no problem.

Mr. Scott: That is right. The same would hold true, I am sure, for the U.S. citizen who was in fact a resident in Canada. I cannot talk about your system of taxation, but under our concepts, if the situation you posed were reversed we would tax him because he is a resident.

The Chairman: Under the present treaty with the United States a Canadian can make a capital gain in the United States without being accountable in the United States for the gain.

Mr. Scott: Yes, if he is a non-resident.

The Chairman: If he is a non-resident.

Senator Phillips (Rigaud): I was covering the point of residence for a transient period.

The Chairman: Moving into a capital gain situation in Canada would not change that position very much, would it?

Senator Phillips (Rigaud): No, but I was just covering the point with Mr. Scott, that in his complaint—in my opinion well justified complaint—as to what would happen if the White Paper were implemented. I was wondering whether he had in mind exempting from capital gain United States nationals resident in Canada for a transient period, in respect of capital gain made in Canada on capital assets situate in Canada.

Mr. Scott: No, sir. Our brief does not purport to get into that at all.

The Chairman: We have had some discussion about Subpart F, and any time anybody talks about it it is shrouded in confusion. Do you think you can add anything to the clarification? I warn you that we will be hearing a witness later in the day, whom I assume you know.

Mr. Scott: Yes, indeed I do.

The Chairman: He is thoroughly familiar with the question.

Mr. Scott: Mr. Caplin is a most capable attorney who was intimately connected with Subpart F when it had its genesis back in 1961. From the standpoint of the National Foreign Trade Council, we would certainly oppose Subpart F. We think it creates an inordinate amount of complexity, both for the government and for the companies involved. It is interesting to note that the current U.S. Treasury is seriously considering—and I stress "considering"—revision or reconsideration of the Subpart F proposals. I am wondering really whether it is worth the candle. Secretary Cohen, the present assistant secretary of the Treasury for tax policy, has stated publicly to the effect that Subpart F represents an inordinate desire to cross every t and dot every i and account for every penny of income. Secretary Cohen has questioned whether the vast effort involved is worth it. From the standpoint of the National Foreign Trade Council, I agree that there should be a better way of coping with the particular problems that the United States faces. We would hope that the tax revision in the foreign area slated for next year in the U.S., part or all of Subpart F would be reconsidered, and hopefully changed or repealed.

The Chairman: What effect do you see if Subpart F were implemented under the White Paper proposals? What effect do you see that having on the companies you represent?

Mr. Scott: Subpart F presents an enormous body of complexity. The minimum distribution provisions, the major relief provisions, without which United States businesses could not function, boggle the imagination. These provisions require some 80 pages of fine print regulations, and most of the major companies in the United States are utilizing the minimum distribution provisions. To superimpose upon this complexity another Subpart F regime, which I am sure would require another set of complexities, would be enormously difficult.

The Chairman: All this is aimed at what?

Mr. Scott: The Subpart F provisions came in in 1961, as originally proposed by the President. There were balance of payment considerations; there were concerns about tax-haven abuse, and about not paying taxes domestically or in a foreign country. The original proposal was to completely eliminate the then deferral of taxation on the earnings of U. S. foreign subsidiaries. As the provisions of the proposals wound themselves through the Congress, innumerable exceptions and safe havens were engrafted on the proposal so that the final product represents the collective compromises of probably thousands of people and probably satisfies no one. It aims, to some extent, at eliminating the deferral of United States tax on the earnings of the foreign subsidiary. It is aimed at bringing money into the country—the balance of payments consideration—and also at insuring that taxes are paid some place.

The Chairman: There is a flow-through of tax in connection with income from foreign subsidiaries?

Mr. Scott: That is correct, to the extent that so-called Subpart F income is currently taxed. Even though not distributed, there would be a corresponding foreign tax credit which would come down with that income. I assume that is what you are referring to.

The Chairman: Yes. If you have the situation where you had a subsidiary of a United States company operating in Canada and that subsidiary had a subsidiary operating somewhere else in the world, how would the income work out? Would it flow through the foreign company into the Canadian subsidiary?

Mr. Scott: You are talking about Subpart F where the income is realized in the hands of the United States shareholders without actually being distributed?

The Chairman: Yes.

Mr. Scott: It would be deemed to flow through to the U.S. shareholder, and foreign tax credits would follow the phantom income that resides in the hands of the United States shareholder.

The Chairman: I take it that you are familiar with what the White Paper says on this subject. Certainly it supports your statement about it being complicated and difficult. It says in paragraph 6.21:

> To counter this type of tax-haven abuse, the United States now provides that when such income is channelled to a controlled foreign corporation, the U.S. controlling shareholders shall be taxed on a current basis whether or not the income is distributed to them.

Is that a correct procedure under the present United States law?

Mr. Scott: The income coming under the Subpart F provisions would have to be based on the so-called tainted income, that is on sales through a base company—services rendered through a base company for related parties.

The Chairman: Then it goes on to say:

> U.S. taxes are levied in the year in which the profits are earned rather than postponed until the profits are returned home.

Mr. Scott: That is correct. If it qualifies as Subpart F income and the various exemptions do not apply, it would be currently taxed to the United States shareholder even though he did not receive a dividend...

The Chairman: It says:

> The government proposes to introduce provisions patterned generally on those in the United States. This proposal involves complicated and difficult law, but the problem is serious and defies easy solution.

I would understand from that that you would support this statement, and, that it is complicated and difficult and defies an easy solution. I have left out the word "serious".

Mr. Scott: I am sure it does defy easy solution. It is indeed complicated and difficult.

Senator Phillips (Rigaud): You need not worry about expressing an opinion; this is a free country.

Mr. Scott: If I may suggest, senator, when you have an evening when you have several hours to kill, that you attempt to wade through the Subpart F provisions. I submit that they represent some of the most difficult passages in the English language. It is a difficult statutory problem and to get to the problem you must have very difficult regulations.

The Chairman: At the end of the road the theory seems to be that if you are presumed to have income flow-through it is also presumed that whatever tax has been paid is capable of securing credit in the United States against taxes payable there.

Mr. Scott: Of course that is only fair. If you are going to tax somebody on income he does not receive it seems to me that we should be consistent and at least allow him the foreign tax credits that should otherwise apply had he made the distribution.

The Chairman: Is it inherent in Subpart F therefore that there must be this two-way street?

Mr. Scott: I suppose there is nothing inherent in what a government does.

The Chairman: I am talking about Subpart F.

Mr. Scott: If principles of fairness apply, then this is inherent. What I am getting at is that it would be unconscionable from the standpoint of a United States corporate investor, and also against the interests of the United States to tax somebody on income he does not receive and yet not allow him the foreign tax credit that our system otherwise provides for.

The Chairman: Supposing the income comes through, say, a developing country to a subsidiary in Canada and then to the United States company, and let us assume that the developing country has special tax incentives or may even have a tax holiday, what happens then in the application of Subpart F?

Mr. Scott: Unless the exclusion from Subpart F income, dealing with investments in less developed countries applied, the income would be currently taxable and the less developed countries' incentive would thereby be vitiated. It flies in the face of incentive type legislation on the part of less developed countries.

The Chairman: It really negates incentive type legislation...

Mr. Scott: Yes, it does.

The Chairman: ...where the income is from a foreign country except if you get the less developing country classification. Is that right?

Mr. Scott: If the income must be reported currently in the hands of the United States shareholder it would negate the tax incentive given by the less developed country.

There has been considerable agitation in the United States over the years to have the United States allow a tax-sparing type credit for investment in less developed countries. In other words, if a less developed country exempts foreign subsidiaries from tax we say that the United States ought to pretend that there has been a foreign tax paid so the U.S. parent could credit the subsidiaries tax against U.S. tax. We have never adopted that philosophy.

The Senate Foreign Relations Committee has rejected this type of tax sparing credit in our income tax treaties. The best that can be had in the United States with respect to incentive type legislation is to have the foreign subsidiary at least keep the money in the foreign country and not be subject to the current U.S. taxation. If you keep it there for 10 years you at least would have the advantage of no foreign tax on the income and the use of the money in the foreign country.

The Chairman: If you bring it home.

Mr. Scott: This would seem to effectively vitiate or negate the less developed countries' incentive.

Senator Phillips (Rigaud): Mr. Scott, I would like to deal with a very interesting point which you have raised at the bottom of page 15 of your brief with respect to thin capitalization and the restriction of deductibility of non-arm's length interest wherever the ratio of debt to stock exceeds three to one. The reason I wish to deal with this point is the following: there is considerable concern in this country, as you know, about what

some regard as not unwholesome but troublesome penetration of foreign equity capital into our country. This is a natural reaction. Views have been expressed that United States investors would be acting a little more fairly to Canadians if they took much more funded debt and allowed Canadians an opportunity to get a little more equity participation than American subsidiaries. That is a natural reaction in terms of the general economy of the country. It would be very helpful if the Americans emphasized funded debt when coming into Canada and to allow Canadians to share in equity participations. I for one, in passing, made such a suggestion when in Washington as part of the Canadian team we met with representatives of your Congress. We have in the White Paper something which is completely at variance with this concept...

Mr. Scott: There is no question about it.

Senator Phillips (Rigaud): ...in the sense that, as you say:

> The White Paper proposes to restrict the deductibility of non-arm's length interest wherever the ratio of debt to stock exceeds 3 to 1.

Mr. Scott: Yes, sir.

Senator Phillips (Rigaud): In other words, if the Americans were to follow Canada's sensitivity and came into Canada more with funded debt and less with equity and invited the Canadians to participate in equity, the net result would be penalization. That would be an atrocious conclusion to arrive at.

Mr. Scott: In this regard, we are sort of on the horns of a dilemma. The so-called thin capitalization provisions would certainly negate taking more debt than was necessary.

Senator Phillips (Rigaud): It would invite more equity stock, which is a matter of concern.

Mr. Scott: It would invite more equity stock, but the equity is not treated necessarily with great kindness either under the White Paper. Certainly, if you were going to have a widely-held corporation, if you were going to give a debt, and then have some wide Canadian participation in the equity, the five-year deemed realization tax would surely penalize the United States investor.

Senator Phillips (Rigaud): Mr. Chairman, I dealt with this question with Mr. Scott because of this amazing indication of the element of inconsistency in dealing with our national problems, on the one hand, trying to reach one type of objective and, on the other hand, bringing about complete negation and destruction.

The Chairman: You will agree, Senator Phillips, that you do not very often find too much logic and consistency in the taxing statute.

Senator Phillips (Rigaud): That does not prevent me from pointing out the inconsistency.

The Chairman: I agree.

Mr. Scott: I would like to make one comment on this. I have read comments in the various tax journals on the White Paper and it seems that some are under the impression that the United States has a 3 to 1 debt to equity rule. We do not have a 3 to 1 rule at all. Our rule is a monstrously complicated rule, and back in 1960 or so Mr. Caplin wrote perhaps the bible on this capitalization entitled, *The Caloric Count of Thin Capitalization.*

Senator Phillips (Rigaud): He has his lineage to warrant the statement that it is a vital one.

Mr. Scott: Under our rule the test is whether in fact you have debt or equity. We have a variety of factors which are considered and are spelled out in Mr. Caplin's paper—12 or 13 of them.

In the recent Tax Reform Act of 1969, we have put in the law a requirement that the Secretary of the Treasury issue regulations with respect to what is stock and what is debt. Even in that legislation, Section 385 of the Revenue Code, five factors are spelled out and they are not inclusive. So I would like to state emphatically that we do not have a 3 to 1 rule. The cases sometimes require a 3 to 1 rule, but most of the cases deal with close corporations. We do not have an automatic 3 to 1 rule.

Senator Desruisseaux: Following this, on page 16 of the presentation, I read:

> Even if the White Paper would include the stockholdings of both foreign and Canadian stockholders in applying the 3 to 1 debt-equity ratio, a violation of the anti-discrimination provisions of section 11 of the 1942 Protocol to the present U.S.-Canada income tax treaty would seem to result.

Could this be clarified?

Mr. Scott: As you know, our income tax treaty, the United States-Canada Income Tax Treaty, has in the Protocol a provision which says that there shall not be discrimination on the part of one country with respect to citizens of another country. More recent U.S. treaties considerably broaden this discrimination clause. What we are really saying at this point is that if Canada denies interest deduction of a Canadian subsidiary of a U.S. Corporation, the Canadian tax would be increased. The United States shareholder does not take advantage of the flow through of the Canadian taxes under the integration proposals whereas Canadian shareholders would.

The Chairman: Not that he does not take advantage, but he cannot.

Mr. Scott: He cannot. So his Canadian brother would receive the flow through of the Canadian taxes, whereas the United States shareholders could not. This is what we are driving at in that statement. Of course, the White Paper is confusing, at least to me. It is not clear really whether all interest is going to be denied. It is unclear as to how it is going to apply. But, in any event, I think this statement is a true statement.

The Chairman: Are there any other questions? Mr. Scott, is there any point that we have not touched, which you would like to develop?

Mr. Scott: I would like to mention briefly two points. One would be the problems that Canada would encounter in the integration proposals when the United States treaty is renegotiated. The United States has taken the position that there should be no discrimination on the part of a treaty partner with respect to the investments of the other treaty partner in that host country. We have taken the position in my opening statement, that the White Paper integration proposals, allowing the flow through of Canadian tax paid by Canadian corporations to Canadian shareholders would perhaps be considered discriminatory when our treaty is renegotiated.

We had the problem—I mean, the United States had the problem in the German treaty. Germany had a split rate tax which would allow a distributing German corporation to pay a lower rate of tax on dividends distributed out to its parent, if the parent was a German corporation.

In the renegotiation of the Germany-United States treaty the United States took the position that this was discriminatory. So, pursuant to the treaty, the reduced split rate provision would apply to a German corporation of a U.S. parent.

In the United States-France treaty, which was recently negotiated, French law had the avoir fiscal tax which is very similar to the proposed integrated Canadian tax. Again the United States took the position that this would be a discrimination against the U.S. investor under our concepts of treaty concepts.

The U.S. got a commitment from the French that, if France were to give a foreign shareholder of a French corporation the benefits of this flow through, the United States would correspondingly receive such benefits. France has recently announced that they are prepared to give the benefits of the so-called avoir fiscal to foreign shareholders and so it was recently announced that this would also be applicable under the U.S.-France treaty.

In Germany, the French avoir fiscal is credited against the German tax; the U.S. shareholder is to receive a cash payment from the French Government. I think this is a problem that will arise when the contemplated renegotiation of the Canadian treaty comes up. Obviously no two tax systems are the same, and there is give and take on both sides.

The Chairman: But the fair conclusion would be, since the United States is knowledgeable on the subject matter, that in any treaty renegotiation with Canada this question would certainly be on the agenda.

Mr. Scott: I am sure it would be. It would be inappropriate for me to suggest how the problem would be resolved.

I would also point out that when the United Kingdom had this integrated tax system it provided the flow-through to foreign shareholders. That was prior to 1965, I believe, when the law was changed.

By way of stress, I should point out the severe problems the United States investor in a widely-held corporation would face if the five-year deemed realization tax were to come in. Those problems would be perhaps insurmountable, certainly credit-wise. It would force the distribution of funds from the Canadian subsidiary which might or might not be in Canada's interest.

Senator Phillips (Rigaud): You have covered that in your brief.

Mr. Scott: That is correct.

Senator Phillips (Rigaud): Mr. Chairman, I believe Mr. Scott's last point is terribly important; that is, that if we introduced an integration system and made it effective prior to renegotiating a treaty with the United States, we would at least during the period of renegotiation and until revision create a system which would be discriminatory to American investors in this country.

Mr. Scott: That would only apply if you interpreted the treaty in a way that we would not interpret it. In other words, the treaty talks about exemption of realized gains; if you are going to take the treaty literally and say it only applies to realized gains but not to deemed realized gains, then what you say is absolutely correct. If, on the other hand, you took the position that it would really encompass deemed realized gains, then it would not be an immediate problem until the treaty was renegotiated.

Senator Phillips (Rigaud): There is the possibility that it could be interpreted as very discriminatory.

Mr. Scott: It could be. There is no question about it.

The Chairman: Are there any other questions, honourable senators? Thank you, Mr. Scott.

Mr. Scott: Thank you, sir. It was certainly a pleasure to appear before you.

Senator Desruisseaux: Mr. Chairman, it seems surprising that a treaty would be in force for so many years on such a matter as taxes. My reaction to it is that it is about time we did something about it.

The Chairman: Yes, that is right.

Honourable senators, may I have a resolution to attach the brief of Union Carbide Corporation to the proceedings of today?

Hon. Senators: Agreed.

The Chairman: The next group presenting a brief to us today is the Association of International Business Corporations. Mr. Phillips will make the opening statement on behalf of the association. With him are Mr. Bruhl and Mr. Ellis. I notice that our list has Mr. Caplin on it and Mr. Phillips has asked me to add the name of Mr. Stanford Ross.

Mr. N. Phillips, Counselor, Association of International Business Corporations: Mr. Chairman, I should like to open this presentation with a very short description of the association. The word "association" is to a certain degree a misnomer. A group of companies decided they had common interests to present, and in the interest of getting the brief in on time the group was termed an association. It was really an ad hoc group comprising about eight or nine companies. It would have comprised a considerably increased number, frankly, had we had the time to get all the various people in; but owing to the early hearing we were not able to. However, I will name a few of the members, which will serve to indicate the breadth of interest. There is the Aquitaine Company of Canada; the Distillers Corporation; the Fraser Companies; the Hiram Walker group; Hunter Douglas; Massey-Fergusson; Rio Tinto Zinc group; and there would have been many others as well. I make these observations because the points presented not only cover the companies involved but cover, as I hope will appear evident, a vast segment of the Canadian economy.

Now, it is extremely difficult to summarize this brief because to a large degree it deals with matters of detail rather than generalities. On the other hand, even though they comprise details they are matters of tremendous import to the companies in Canada, or to a large number of them.

We can roughly divide the points into two groups: those which apply to the corporate operations of the companies involved and those which apply to those companies which have foreign shareholders and primarily controlling foreign shareholders.

Within the first group of points, we would propose to deal with the sections dealt with starting on page 3, which are set forth in more detail on pages 4 and 5, items 1 to 5. The second group of points has been before this committee before so that, with your permission, we will deal with them on a somewhat shorter basis. Those points commence on page 19 and deal with some of the points mentioned in previous briefs presented to you—such as the problems of capital gains

tax, foreign shareholders, distributions to foreign shareholders and the famous five-year revaluation plan.

With your permission I should like briefly to go through the major points as they are presented in this brief. The first one is the proposal of paragraph 6.15 of the White Paper, which would continue the tax exempt receipt provision of dividends from foreign subsidiaries, but only from foreign treaty countries. It would not apply to non-treaty countries where a somewhat complex tax system is devised which would bring the dividends fully into income and then give credit for both withholding tax and the profits tax as paid to the foreign country by the foreign corporation.

Senator Macnaughton: That would be starting on page 5.

Mr. Phillips: That would be starting on page 5. Now there are some major points that the association would like to present; if I may direct the committee to the list of countries with which Canada presently has tax treaties. which are set forth on page 5, it is perfectly clear, if you read the names there, that, with one or two exceptions, all these countries constitute the highly developed countries. There are very few members of the so-called third world, the poorer countries. Therefore in the opinion of the association, we have the strange situation that their penalty is being imposed upon Canadian companies which form foreign subsidiaries in the underdeveloped countries, whereas the benefits are being given in respect of subsidiaries in the developed countries. Now it is our understanding that this runs counter, to a large degree, to the policy of attempting to induce private investment in the more underdeveloped areas of the world. So, on the one side, you have, for instance, grants and gifts of money to underdeveloped countries, and yet your tax system is being designed in a way which would essentially make it difficult, if not impossible, from a tax point of view at least, to carry on business privately in underdeveloped countries.

The Chairman: I think, Mr. Phillips, that we have an organization, don't we, operating under the External Affairs Department or one of the other Government departments supervising expenditure of moneys in underdeveloped countries of the world?

Senator Molson: CIDA.

The Chairman: And there is encouragement to industry to establish in those countries.

Senator Macnaughton: The External Aid Division of the Department of External Affairs.

Senator Desruisseaux: It seems also that we have a Crown corporation or two that operates in many countries as subsidiaries, such as Polymer. They have subsidiaries in the United States and in Mexico and other countries.

The Chairman: Yes, but we were discussing this in its relationship to the developing countries. You would have to say that France and some of the other countries you mention had matured.

Mr. Phillips: In any event, to summarize, the point the Association wishes to make is that it does not feel that this is a logical division that non-treaty countries should not have the same benefits as highly developed countries in having free dividends from 25 per cent or more owned subsidiaries of Canadian companies. The Association is aware of, perhaps, the reason for this which was the loophole worry which will be dealt with more directly when we come to the passive income concept. There is also one more or less tendential point, namely that what is given in the White Paper is a credit for foreign corporate tax on profits, but nothing else for any of the underdeveloped countries, and in effect it is reducing a foreign subsidiary of a Canadian company which is setting up in an underdeveloped country. It is literally being forced to go to the government of the underdeveloped country and say "look, you amend your tax act or impose taxes in this way and we will do business here, but if you don't impose it in this way, we won't do business here." I need not tell you that that is not the kind of situation that is desirable in terms of our relationship with underdeveloped countries.

I propose for the moment with your permission to pass by number 2, commencing on page 7, because we will come back to this at the end when we will have the testimony of Mr. Caplin and Mr. Ross. So the next point is that on pages 13 to 14 of the brief, which is an offshoot of what was previously said. The flow through of withholding tax credit is to be limited to 15 per cent which is effectively limiting it again to the treaty countries. So that if a Canadian company is operating

through a subsidiary in an underdeveloped country where more often you will have a higher withholding tax in the absence of a treaty, the credit will only be given for 15 per cent of whatever the foreign withholding tax may be. Once again, it is another example of the prejudice of the White Paper against the underdeveloped countries but it is not a conscious prejudice, I would respectfully say. It is because they treated the vast number of non-treaty countries almost, one feels, as a wholesale loophole haven the world over, without paying any attention to the fact that there is real investment in a large number of countries which have no tax treaty with Canada.

Passing then to item number 4, we find it is a very important point from the point of view of the association. This is section 3.47 on the so-called tax-free roll-over privileges—I think it is the tax-free reorganization section, where you can do something and not pay a capital gains tax but proceed through a roll-over. In this case the White Paper was pretty draconian in its approach. It said that it just excluded foreign corporations holus-bolus and completely from the free roll-over provisions, the grounds presumably being that "the provisions necessary to achieve the ultimate result would be too complex." It is interesting to note that when dealing with section 6.21 which has to do with the imposition of taxes, the White Paper did not have difficulty with complexity, but where complexity results in tax relief, they felt it was unnecessary to proceed. The members of the association urgently request on this point that the tax-free, roll-over provisions be substantially extended following, we believe, although perhaps Mr. Caplin will have something to say on this point, that the United States has now decided to greatly extend its tax-free reorganization sections to include foreign corporations. We will also show, I hope, in due course, that the loophole fears are not real, and this will come when we deal with the passive income.

Point number 5 is a difficult one to present to the committee because it really does not deal solely with foreign corporations. The only reason it appears in the brief is that unless I stand corrected, at no point in the White Paper is the subject of cost basis dealt with. In other words, if somebody makes a capital gain, what is the cost of his asset? In the United States Internal Revenue Code, the whole question of cost basis and tax reorganization is infinitely difficult. Strangely enough, in the White Paper the only time it is dealt with is in section 6.19 where it is provided that if you receive a dividend from a controlled foreign subsidiary in a treaty country which would be non-taxable, the amount of the dividend would reduce the cost of your stock in the foreign subsidiary so that if you ever sell it, you make a bigger capital gain subject to tax.

Now, what appears nowhere in the White Paper and what I suggest respectfully is a vastly important point because it covers the whole area of the White Paper, is the total absence in the White Paper of provisions for increase of cost basis of non-deductibles. Perhaps with the chairman's permission, I may give a few examples. If you borrow money to buy shares, and let us assume—nobody can really tell what the rules will be—but let us assume that in a particular case in point the interest is non-deductible, nothing is said as to whether that non-deductible interest will go to the cost of the shares and increase the cost of the shares on subsequent resale. Let us take perhaps a broader point; a man owns a house and he has a mortgage on it. His interest is going to be non-deductible because it is a private investment. If he sells the house within the limits of the White Paper, he is going to be subject to capital gain. So, will the non-deductible interest expense be added to the cost of his house? If he buys a painting or if he buys any item, everything is going to be subject, gentlemen, to capital gains tax but nothing is said as to what happens to increase the cost of the asset in respect of items that are not deductible.

The association would take the position that a general rule should be formulated whereby all non-deductible items which are related to capital assets should be permitted to increase the cost of those capital assets for purposes of the subsequent capital gains tax.

This wording is not contained in the brief, but is perhaps the summary of the overall thrust of the various points made.

The Chairman: You suggest that if you establish a value for purposes of capital gains on a valuation basis, that valuation basis would not reflect an item such as non-deductible interest.

Mr. Phillips: Senator Hayden, on valuation day you have a value and past history is forgotten.

The Chairman: Yes.

Mr. Phillips: However, future expenses related to that asset, which are non-deductible in the computation of current income, must be dealt with somewhere. Nowhere do you find this in the White Paper. It can be dealt with by allowing everything spent as a deduction, which is obviously impossible, or an expenditure related to a capital asset which is not deductible should be added to the cost of that asset for subsequent capital gains.

The Chairman: Or deducted from the gain.

Mr. Phillips: Yes.

The Chairman: Your statement was a little too summary then, in that you did not indicate a starting point for the rule that you were proposing, which would be valuation day.

Mr. Phillips: I apologize to the committee. Prior non-deductible charges, of course, would not apply. Everything starts from valuation date.

With reference to taxes on corporate distributions, this committee has had before it the experience in the United Kingdom, which is also set forth here commencing on page 20.

The committee has also had before it in other briefs the questions of the avoir-fiscal system in France and the problems in the French-German treaty. I have no knowledge of the U.S.-German treaty as mentioned by Mr. Scott. We discussed the U.S.-French treaty, with which I am familiar.

The Chairman: Is there not a limitation in the exceptions made in the French-U.S. treaty as to the amounts to which the exception may apply?

Mr. Phillips: As I am not that familiar with the details of the treaty I will ask Mr. Scott or Mr. Caplin to answer.

Mr. Scott: The avoir-fiscal applies to investments in the United States less than 10 per cent.

Mr. J. P. Bruhl, Secretary, Hunter Douglas Limited, Association of International Business Corporations: The reason for making the definition on the flow-through of the avoir-fiscal under the French treaty with the United States was that the French imposed a withholding tax of only 5 per cent on other types of investment.

The feeling was that with such a minimal withholding tax the United States should concede on that point.

The Chairman: What was the concession?

Mr. Bruhl: That investors who are subject to a 5 per cent withholding tax only would not receive the additional benefit of avoir-fiscal flow-through.

Mr. Macnaughton: If I am not mistaken, we already have on record the quotation referred to on page 20 of this brief. If that is not the case, it would be placed on the record.

The Chairman: Yes. That is in the study made by Mr. Gilmour.

Mr. Arthur W. Gilmour, Senior Adviser: Yes, it is in Appendix A.

Mr. Phillips: A relatively complex point was made in at least one brief, but may not have been totally apparent.

If the integration proposals are implemented and there is going to be a creditable tax for distributions, one of the points that seems important to be fitted into the integration proposal is an ability of the declaring company to designate from which types of surpluses it pays its dividends.

For example, consider the case of non-resident shareholders who at least at the moment under the White Paper get no benefit from the creditable tax. One would assume that a provision should be introduced to permit the creditable tax to be only expended vis-a-vis declarations to resident Canadian shareholders.

It would be necessary to have different kinds of surpluses in the company from which dividends would be declared, at least for tax purposes. Therefore the creditable tax would only be used for resident Canadian shareholders and not wasted vis-a-vis distributions to non-residents who pursuant to the White Paper are to receive no credit therefrom.

The Chairman: How would you overcome the statement that a dividend is a dividend?

Mr. Phillips: The complexities of the integration system lead the association to the point where it thinks it should be scrapped in its totality.

Since, however, it must work within the context of the White Paper proposals, we can only offer suggestions and say that from a tax point of view it does not affect perhaps the

corporate procedures. However, something must be done to segregate the tax credits in the companies so that they are only used on behalf of those who benefit from them.

The Chairman: There would have to be a class of shareholders. How are you going to have two different sources of dividends to the same class of shareholder?

Mr. Bruhl: Consider a company which has domestic earnings in Canada and also receives foreign dividends, or has foreign branch earnings.

If a tax law would permit that for tax purposes only the corporation could designate that if a general dividend is declared on all its shares they would allocate to their resident Canadian shareholders the earnings, as source of the dividends, that are made in Canada for tax purposes only. They could allocate as dividends for shares held by nonresidents the earnings from foreign subsidiaries and branches.

The result would be achieved and the corporate mechanism of declaring dividends would be unaffected. It would merely be an election for tax purposes.

The United States and some other contracts permit taxpayers to be treated as if they had received dividends if they make an election, even though no dividend is actually declared.

Any solution following this approach would rely on the fiction, for tax purposes, based on the election by the declaring corporation.

The Chairman: Yes, the ordinary tax dividend declaration in Canada goes something like this: the dividend is declared out of the net profit of the company.

You suggest that you could have two different types of dividend declaration.

Mr. Bruhl: I believe that the dividend declaration language could remain as at present. But for tax purposes the corporation would then file an election with the Canadian revenue authorities, under which they elect to allocate certain surplus derived from a certain source to dependent domestic shareholders, and other surplus to dependent foreign shareholders.

Mr. M. J. Ellis, General Tax Manager, Association of International Business Corporations: If I may pick up this point, under integration every corporation distributing a dividend to a Canadian shareholder would have to specify in the dividend slip that the shareholder gets the amount of creditable tax that goes with the dividend.

The Chairman: You are not now talking about the withholding tax?

Mr. Ellis: No.

The Chairman: That would still apply.

Mr. Ellis: Yes, certainly. As far as the Canadian shareholder is concerned, the corporation has to calculate when it distributes the dividend the amount of creditable tax that accompanies the dividend. The procedure proposed in the brief would simply permit the corporation to allocate all creditable tax to the Canadian shareholder and none to the foreign shareholder.

The Chairman: If some shareholders are denied creditable tax because they are foreign shareholders, what you say is that the principle should be established that the company should be able to pay them out of non-taxable income or revenue.

Mr. Phillips: Non-creditable tax income, which would be, for instance, on page 22 of the brief, the foreign earnings of the Canadian company, because foreign taxes do not flow through for the dividend tax credits, so you have to have a series of segregated accounts, which while complex, presumably, would achieve the end.

The Chairman: Being complex, in this case if it provides relief maybe we should have a look at it.

Mr. Bruhl: If I may make one more point in this connection, presently there have to be allocation rules anyhow if the integration proposal is adopted, because you have to decide within which surplus a dividend comes if less than the entire surplus is distributed, so it would be only a modification of the allocation rules which would be required in any event.

Mr. Phillips: I think in the interests of brevity I will pass by some of this. There is a considerable amount of additional material, although there may be questions on it, but I will not now take up the time of the committee.

There is one mistake on page 25. In the second paragraph, in the third line from the end of the paragraph the reference to Canadian tax of 10 cents should be 25 cents.

I turn to item 2, commencing on page 26, and item 3, commencing on page 30. That is again the same material but in a much more developed form than has been presented to this committee before, basically dealing with the nontaxability under all circumstances of sale by foreign shareholders of their shares in Canadian companies, and the five-year revaluation rule. I would not propose to deal again with this in detail, unless the committee so desires.

The Chairman: We have heard a lot of representation on that.

Mr. Phillips: I do not know how to handle this. Would you like to have a question period before we get into the passive income section, or should I deal with the passive income section right now and Mr. Caplin's testimony? It is entirely a matter within your discretion.

The Chairman: There may not be many questions arising out of what you have dealt with so far. If there are any, it covers ground that we have been over many times, and the chairman has been interjecting. I think you can assume that there are not any further questions on the points you have developed at this time, reserving out of that that we want to hear Mr. Caplin, and we also want to hear you with respect to the passive income.

Mr. Phillips: If I may, I will now deal, commencing on page 7 of the brief, with the major proposals on passive income. The proposals on passive income in section 6.20 and 6.21 I suppose could generally be lumped together under the concept of the loophole provisions, which prevent what the White Paper considers generally to be improper avoidance of tax. The drafters of the White Paper seem to have been imbued with a sense that there exists in Canada today a monstrous amount of tax avoidance, that these provisions are absolutely necessary, that they have to be introduced in order to cut off this unwarranted flow of funds that should be, let us say, morally subject to tax in Canada.

However, it is interesting when you look at the figures the White Paper provides to see that the total changes are not expected to raise revenue in excess of $10 million, in paragraph 8.29, which incidentally includes some things probably beyond the loophole provisions themselves. One is a little puzzled to see how on one side we have right through the whole of the White Paper this feeling of vast loophole closing, and yet when it is all over the total recovery is to be under $10 million.

The Chairman: Oh yes, Mr. Phillips, but you must qualify the reference to loopholes, because some of the loopholes they talk about are to cover loopholes their proposals will create. Do you not realize that?

Mr. Phillips: Yes, sir.

If you look at the areas the Government has been considering in the White Paper, they do not specifically relate to any particular type of tax avoidance, except tangentially as you go through it. Basically they would seem to apply mainly to companies using offshore companies to step up the cost of property and inventory, which is either sold to foreign purchasers, or supplies that are brought into Canada, where you raise the cost of purchase or lower the price of sale through the use of offshore subsidiaries; or secondly, the so-called incorporated foreign pocketbooks, where you have individuals, or perhaps companies, using offshore companies to earn investment income which is not subject to tax because of the foreign corporation, but had it been done in Canada would have been subject to tax.

It is the feeling of the association—I leave aside for the moment the whole question of Subpart F which will be dealt with—that the present Income Tax Act has more than enough provisions to cover any conceivable real tax avoidance schemes that are now in existence, or perhaps most of those that could be conceived.

The Chairman: Let us take a few examples. Let us take royalty income. You have a Canadian company that may have patent rights, not only in Canada but also in various other countries. Let us assume they set up an offshore company and sell or assign the patent rights, and then this offshore company carries on the transactions and receives the income from various countries. Is that the concept or part of the concept of passive income under the White Paper?

Mr. Phillips: I think it is a fair guess. The one they particularly cite in section 6.4 is the corporation that sets up a foreign company to buy Canadian bonds. I think that is the example they give. This is always a guess, but I think in probably 90 per cent of the cases, in factual situations of this type, the present Income Tax Act could bring that company back into Canada as a resident of

Canada, because in virtually all of these circumstances it is truly managed and controlled in Canada. Conversely, if the operating abroad is of such complexity that it truly needs management control abroad to run it, then it is not a tax avoidance scheme. It is either one or the other.

If you take the example given in section 6.4, on the facts as they seem to be given here the offshore company talked about would probably be a resident of Canada. All it is going to do is buy a bond. Decision would obviously be made at the head office and they do not need law.

The association took the liberty of setting forth on pages 10, 11 and 12 the existing sections of the Income Tax Act that were avaialble. The fault, respectufly, is not with the law. The law is quite good and very comprehensive. The aresenal is there. It is basically the inability of the adminstrative process to put it into force. There certainly seems to be no guarantee that vastly complicated law is going to increase the efficiency of the administration and, if anything, it will not. We have very good, competent and simple provisions which if administered capably would correct all the abuses now raised. It is difficult for the association and the companies to understand how this vastly complex increase of statutory law is going to add very much to what is already there.

Senator Beaubien: Before we leave that point, perhaps Mr. Gilmour would say a word about it.

The Chairman: I had a question which I was going to ask Mr. Phillips. Shipping is mentioned in paragraph 6.4. It says:

> Some types of income (e.g. foreign dividends, rents and royalties, shipping income and some export profits) are easily diverted to the so-called tax-haven jurisdictions.

I do notice in section 10(1)(c) in regard to amounts not to be included in computing income it says:

> the income for the year of a non-non-resident person earned in Canada from the operation of a ship or aircraft owned or operated by him, if the country where that person resided grants substantially similar relief for the year to a person resident in Canada,...

This shipping income is the subject-matter included in many of our tax agreements, is that not right?

Mr. Phillips: Yes, sir.

The Chairman: We are making trade with another country. We say that if the income is earned by a resident of that other country, then that country is the only one that may tax that income. Is that not the effect of the tax treaty?

Mr. Phillips: Yes, sir. The key is what constitutes a resident of the foreign country. If the offshore company is no more than a delusion, merely created in order to siphon off from the Canadian tax the operation of a ship, you do not need to amend the present law to get at it. In fact, one of the Tax Appeal Board cases referred exactly to that point. The court said that if the company was resident in a place and a 100 per cent shareholder, then this is where the company or the operations were managed and controlled. It may be that under the Income Tax Act the concept of where a company is managed and controlled might be extended on certain technical rules to where the directors' meetings are held. It is not entirely satisfactory. The House of Lords—I do not want to get into too much technical law in the United Construction case—said that they should get down to the facts and that if a company is managed and controlled in the true factual term in a particular place, then it is a resident.

Now, virtually all of the so-called avoidance tax schemes which are exercising the drafters of the White Paper could be corrected by that. Let us take a look at section 17 of the present law. It talks about purchases and sales between persons who are not dealing at arm's length. This would occur in most of the offshore subsidiary operations where the offshore subsidiary had not honestly performed a business function. Respectfully, gentlemen, if it is performing a business function then it is not a tax avoidance scheme and if it derives a profit from the exercise of the business function it should not be taxed in Canada.

Mr. Ellis: I would like to add one point on the question of where a Canadian company assigns certain rights to an offshore subsidiary. If this is set up as a tax avoidance scheme the key to the solution is the price at which the Canadian parent transfers the patent rights to the foreign subsidiary. If this

price is too low, the transaction is not at arm's length and should be corrected under section 17. This company could be established if the price of the assignment is $1 and, annually, if the subsidiary collects $100 in royalties, there is obviously a discrepancy there.

The Chairman: There may be national reasons where you have to be a national of the company in order to do a certain type of work or business.

Senator Beaubien: That is a very important point. I was wondering if Mr. Gilmour fully agrees with Mr. Phillips' analysis.

The Chairman: Let us put it this way. We do not want to get a lawyer and a chartered accountant into conflict—Mr. Gilmour, have you anything to add to the discussion?

Mr. Gilmour: In this case I am delighted to say that there is no conflict. I have been listening to Mr. Phillips very carefully and nodding in agreement because I agree completely that the White Paper seems obsessed with tax avoidance and that our present Income Tax Act is loaded with sections. The theory that it is immoral to transact any business outside Canada seems to be brought out again and again in the White Paper, and I think it is nonsense. The amount of tax evasion is very small, from my own experience which is quite lengthy.

Senator Beaubien: I am satisfied, Mr. Chairman.

Mr. Phillips: I will ask Mr. Bruhl or Mr. Ellis if they have anything to add. To summarize this point, it is the position of the companies forming this association that we have a very fine Income Tax Act right now, and literally divisions and armies of legislation to protect against tax avoidance. The administration is perhaps the problem, but we do not feel that administration is improved by additional legislation as such.

The Chairman: It has been suggested, Mr. Phillips, that it may be difficult to get information in connection with operations outside Canada. I would think you would have to discount that suggestion because the Canadian company that has created this situation in carrying on transactions with this offshore company must have something in its financial statements which will identify in some way the transactions and will alert the investigators so they can ask for more money.

Mr. Phillips: I think I am also right in saying that the Canadian Income Tax Department can request any amount of information that is required from the Canadian company and get it.

The Chairman: We must not forget the tax treaty arrangement providing for the exchange of information. In all the tax treaties that we have there is a specific paragraph providing for the exchange of this kind of information. I know so far as the United States is concerned that the U.S. investigators from the Department of Internal Revenue will come up here and conduct a hearing and the Canadian representatives and will sit in on the inquiry or discussion. All of the questions will be asked by the United States investigator. The exchange of information is very complete. I would add that if you have an offshore company in a country which does not have any tax, then you have a problem with respect to exchange of information. You have got to get your own information.

Senator Molson: Mr. Chairman, you are talking specifically about shipping. It is running through my mind that the flag of convenience procedures, which are very popular in shipping circles, do not prevent any peculiar complications from our tax point of view, do they?

Mr. Phillips: As such?

Senator Molson: Yes?

Mr. Phillips: I do not think so. The question of taxability depends on the residence of the owner. If you have a foreign corporation, wherever it may be, and if this were necessary for a flag of convenience—I do not know about it even to say—you could easily make the company resident in Canada if it is controlled from Canada. That is the key point. If it is not controlled from Canada, it should not be taxed in Canada.

This is the theory of taxation, that you should pay a tax in the country where the profit is earned. If the work is done abroad, then it should be taxed abroad; or, if it is not taxed there, it should not be taxed in Canada, certainly. You cannot certainly just arrogate a tax to Canada because it sounds good.

The Chairman: I think Mr. Gilmour could add something about flags of convenience.

Mr. Gilmour: On the question of shipping profits, it has been pretty well established that, as our chairman said, that the country

that owns the ship has the earnings from the ship allocated to it. We had the section 10(1)(c) that our chairman referred to, and it says that Canada will not tax the profit from ships or aircraft owned by a non-resident if there is an equivalent exemption given in the other country. There are quite a few countries, so-called "flag of convenience" countries. The one that springs to my mind offhand is Liberia.

Senator Molson: And Panama?

Mr. Gilmour: And, of course, Bermuda. If you ever take a trip on the Great Lakes, it is surprising the number of ships whose port of registry is Hamilton, B.D.A. The problem that you run into is that Bermuda as an example does not levy any income tax at all. Therefore, even if you had a Canadian ship trading into Bermuda waters, Bermuda could not and would not tax it, because it has no income tax. Conversely, if you have a ship owned and registered in Bermuda, the question is, does that fit under our 10(1)(c). In practice it has.

Liberia, on the other hand, has a very specific provision. Its act is copied to some extent from the United States internal revenue code and you do have a definite exemption from Liberian income tax. That is why you will find a great many of the tankers of the world are registered in Liberia.

In our own land, we do not have a merchant marine any more. If we did, it would be rather silly to put the profits from international trade into a Canadian company, because it is actually so much cheaper to run a ship from somewhere like Liberia. It would probably break up if you go much east of the Gulf. Nevertheless, you could still register it in such a country.

Most of the companies that have moved to Canada are indirectly Canadian-owned ships that have used these flag of convenience countries.

You find that the maritime commissions try to keep the registration of the ship restricted to a country that would probably be our allies in the event of war, namely, the British Commonwealth or United States or somewhere where Canadians have influence.

The basic rule of tax evasion is, if you are earning your income out of Canada, there is absolutely no reason why you should not use a foreign subsidiary to earn that income.

If, however, you are diverting Canadian source income by some device—and there are lots of devices—then most of us feel that that is not quite sporting. If the income in fact is earned in Canada, it is really tax evasion to move it. But where your income is earned beyond Canada, I do not think the same rule applies, because where you are free to open a foreign subsidiary, why not? But the White Paper proposes, of course, to catch that.

We adopt the United States procedures and, as Mr. Scott mentioned this morning, and from everything I can read on the subject, the United States procedures are under serious criticism in their own lands. Our own feeling is, why should we be saddled with a system that is criticized in the United States by Americans—not by us—any more than we should adopt the integration system that the British threw out. Therefore this question of tax evasion really is a very simple one, when you boil it down—is the income earned in Canada? If it is, it should not be diverted.

The Chairman: I suppose that an illustration holds, that I used the other day, that is, you have a manufacturing company in Canada and they have set up an off-shore company and established that off-shore company as having all the rights of sale in foreign markets excluding Canada. The next step is that that company has got to get goods, and the whole purpose of the exercise is for it to use the goods of the Canadian manufacturer. So then you have the Canadian manufacturer selling the goods to the off-shore company, at a price that permits *the* element of profit really to be made by the off-shore company in selling on the foreign market.

That might be an example of the sort of thing you are talking about, that is, that it is really Canadian source income. It could have been earned in Canada, but the way it is being set up is that the major portion of the earning and profit, with the co-operation of Canada, is being made in the off-shore company.

Mr. Gilmour: Yes, except that in practice such a trans-shipment company, as the White Paper calls it, is just about impossible to operate, because of the existence of the subdivisions 1 to 4 of section 17.

Mr. Phillips: Section 17.2 provides that where a taxpayer carrying on business in Canada sells anything not at arm's length at a price less than fair market value, the Canadian taxpayer is deemed to have received the

fair market value. We do not say that the problems are not there yet. It is that we already have more than enough law to cure it, if it is there.

The Chairman: All I was doing is citing this as an illustration of what might be the kind of thing the White Paper is talking about; but they have got authority now to do it.

Mr. Phillips: And they are now doing it.

Senator Molson: Commissions for the off-shore company on profits on sales.

Mr. Phillips: If they are doing a real job, perhaps it is entitled to do it.

The Chairman: It depends on what it is doing.

Senator Molson: Selling Canadian goods from the Canadian parent.

Mr. Phillips: If it did nothing else than act as a sham, then even under section 17, or on the grounds that the off-shore subsidiary is itself a resident of Canada, I think you have the matter cured right there.

The Chairman: Mr. Gilmour has one more point to add.

Mr. Gilmour: I would like to point out one thing. Our tax laws do nothing to help the Canadian exporter. If he sells directly, the revenues from Canadian sales fall into the income of the Canadian company. If he sells through one of these trans-shipment companies, or buys through one of them, then section 17 catches him.

This same problem is very much under consideration in the United States at the present time. There, with the tightening of the international market, the Americans have found that their system that is proposed for us is actually hurting their export trade.

I realize I am in the presence of experts here, but, judging from my own reading, thinking in the United States seems to be that they had better overhaul their own system; and they are giving very considerable thought to some form of assisting export sales.

We in Canada to nothing for that. Perhaps we should. But that is the major criticism we have of our act. This is going to be compounded if the White Paper saddles us with the unsatisfactory United States system.

Mr. Phillips: Mr. Chairman, with the permission of the committee, the association would like to introduce to the committee Mr. Mortimer M. Caplin. He is a member of the Washington law firm of Caplin and Drysdale. He served as Commissioner of Internal Revenue of the United States from 1961 to 1964, resuming the practice of law at that time. Before becoming Commissioner of Internal Revenue, Mr. Caplin was a professor of law at the University of Virginia, specializing in tax and corporation law.

Mr. Caplin is accompanied by his partner, Mr. Stanford G. Ross, formerly Assistant Tax Legislative Counsel of the United States Treasury Department, where he was one of the principal draftsmen of the foreign income provisions of the Revenue Act of 1962. Mr. Ross later served as a White House Staff Assistant on Economic Matters to President Johnson. He is presently Chairman of the Subcommittee on Subpart F of the Committee on Foreign Tax Problems of the American Bar Association Section of Taxation.

Mr. Mortimer M. Caplin (Caplin and Drysdale, Washington, D.C.), Consultant, Association of International Business Corporations: Mr. Chairman and honoured senators, we are indeed privileged to appear before you today and to try to share with you some of our experiences under recent United States developments in the international field with particular reference to the controlled foreign corporation problem which Mr. Phillips and you have now been discussing.

I should like to make clear at the outset that we are not here to be an advocate for or against your Government's White Paper. It would be presumptuous of us as foreign guests to do that. We just are attempting to present this experience for you to evaluate whether it applies to your particular situation. I should like to begin by describing the background of our adoption of Subpart F of 1962 to illustrate the importance of its adoption and our balance of payments problem at that time.

As you are aware, for almost 15 years the United States has had persistent problems with its balance of payments position. These problems have caused every administration in the United States, beginning with that of President Eisenhower, to analyze the effect on the balance of payments of its rules taxing foreign income. This analysis has led in the past decade to a great deal of experimentation in the use of the tax law as an instrument of foreign economic policy. In 1961 President Kennedy made tax reform one of his

principal objectives. He proposed to Congress in April of 1961 a series of tax reforms, including a recommendation that deferral of United States income taxation on foreign operations be eliminated and that deferral of United States income taxation on tax haven corporations be eliminated.

I might pause to point out that, if a foreign corporation is controlled by a United States corporation, even owned 100 per cent by the United States corporation, the basic rule is for the United States not to tax the income of that controlled foreign corporation. This is what we refer to as deferral. The income is held abroad. It is deferred. It is only when the funds are repatriated to the United States that a United States income tax is imposed. But even that income flow carries with it a foreign tax credit, and in many instances, where the tax of the foreign country is equal to or greater than the United States tax, there would be no further impact. Indeed, we would have an excess foreign tax credit to be used for other purposes.

The administration had argued that deferral of taxes might have been justified after World War II, when Europe was undergoing reconstruction and we were attempting to assist in that reconstruction; but, certainly by 1961, western Europe had recovered and the growing balance of payments problem was of deep concern to our country. The administration believed, and urged strongly before Congress, that by taxing the income of American-owned foreign corporations on a current basis, taxing them immediately, of course with the foreign tax credit carrying through, it would eliminate any incentive to investment in foreign countries. That was the point in focus: to eliminate incentives to improve our balance of payments situation.

Faced with strong taxpayer opposition to that pattern, the Congress adopted Subpart F, the complex sections we have been focusing on this morning. They did it only as a compromise measure.

We have a unique system of tax legislative function. The administration proposes and Congress disposes. Frequently, the Congressional answer is entirely different from the administration's. How true that was in the Subpart F solution. The final solution reflected an attempt to support the Treasury's economic goals—to wit, improved balance of payments—while accommodating to the realities of business life that were stressed by the corporate communities.

Incidentally, I suppose I might pause to note that, fortunately, you do not have the balance of payments problem we have continuing today so that, happily, this inducement to adopt a Subpart F does not prevail in Canada.

To reiterate what I noted before, under prior law no United States tax was imposed on earnings of foreign subsidiaries until they were remitted as dividends to the United States parent company. Upon receipt by the parent company the dividends were subject to United States tax at the same rate as profits from domestic corporations, with a credit for the foreign taxes paid with respect to the dividends.

Simply stated, Subpart F imposes a current tax on specified earnings of foreign subsidiaries equal to the difference between the relatively high United States tax and the low foreign tax of a particular country involved. The legislation seeks to eliminate in some situations any tax advantage in holding profits abroad in foreign subsidiaries, as opposed to repatriating the funds to the United States. The accommodation of the competing views of the Government—again to improve balance of payments—and the business community was accomplished largely by means of something which we called "a minimum distribution". This minimum distribution machinery which was quite complex and is built into the statute eliminates from some Subpart F coverage those foreign subsidiaries of domestic companies which either pay high taxes abroad or made substantial current dividend distribution to the United States or a combination of the two—where they pay medium high taxes abroad or medium amounts of taxes—and they pay additional distributions to the United States parent. In other words, this is a safety valve, and remembering always that this minimum distribution, when they made a current distribution back home, the United States parent company was given a credit for the foreign taxes paid on that income, and the net of all this is that the legitimate business corporations of America performing real business activities abroad, through the minimum distribution ruling live quite happily although in an extremely complex way with the maze that was created in 1962. It must be emphasized that this minimum distribution rule is the heart of the compromize made that ultimately enabled passage of this legislation.

The Chairman: May I ask a question at this stage? Would you say that this minimum dis-

tribution rule was to encourage the bringing home of foreign earnings?

Mr. Caplin: That's right. They were using a plan that if the tax abroad and the tax on the amount of distribution made back home—which may be only a partial distribution—amounted to about 90 per cent of what the United States tax would have been if it had everything at home, then they said "we are not going to impose any further taxes on the package. We are not going to use Subpart F, in other words."

The Chairman: The effect then really was to perpetuate the flow-through that formerly existed when dividends were brought home?

Mr. Caplin: That is right, and beyond that, Mr. Chairman, when you have a business company operating directly in many of the high tax countries of the world and in addition might have what is called a tax haven in Switzerland, by putting the whole thing together on a composite basis, they might well meet this 90 per cent test. By looking at the high taxes in some countries and the low taxes in tax haven countries, the net of it all is that they are still paying 90 per cent United States tax and it permits United States companies—and if you had the situation in Canada, it would permit Canadian companies—to operate abroad competitively with other foreign companies seeking that important foreign market. I think our Congress in the last analysis had the good business judgment not to impose any competitive restrictions on the *bona fida* business corporations of America.

The Chairman: How would you define this 90 per cent ruling?

Mr. Caplin: Well, it says that no minimum distribution is required where the effective levels of foreign taxes are within the 90 per cent of the United States rate. That is a brief summary of it; it is really quite a complex provision. It covers about 60 or 70 pages of the regulations. I should say that through this minimum distribution concept, the United States accepts the fact that multi-national corporations will organize their affairs to reduce taxes in any way which is customary and which is accepted in foreign countries, or perhaps I should say in the host countries. Again, I have elaborated on the balance of payments background because so much has been said in the White Paper, or at least inferred, about Subpart F being intended to counter tax abuses. It was not primarily conceived to counter tax abuses.

Apologetically in a way I might say that Mr. Ross and I were in on the creation of Subpart F; I was in the revenue service at the time and Mr. Ross was in the Treasury, and we lived through this period. And while different people may have had different motivations, certainly the treasury in its presentation and the Congressional Committee reports, and really the ultimate facts of life made it very clear that this legislation would not have been adopted had it been regarded as a tax abuse corrective. It was a balance of payments argument and presentation that carried the day.

Our internal revenue code, just like your tax law and the provision that Mr. Phillips referred to, contains a number of traditional tax avoidance provisions such as requirement for arm's length dealings between related parties, a very important provision giving the Government the power to reallocate income and deductions among related entities, the ability to disregard sham corporations or corporations which do not have any legitimate business function and are artificial in nature, and many others. This is built into the tax laws. It is fundamental; it is fundamental to your law, and here are the traditional tools used to cope with the problem at hand. And these provisions fully and properly implemented by administrators, and backed up by competent and well-trained administrators can be an adequate arsenal for the defence against abuses in the international area.

Now that the primary thrust of Subpart F is in the area of balance of payments can be demonstrated, I think, by examining the treatment in Subpart F of sales and service companies. Now such companies, as your Chairman has pointed out, have been set up in tax haven countries to syphon off income from related manufacturing or distribution companies. Thus a Swiss subsidiary of a United States company may be used to sell goods produced by related corporations in France to another related corporation in Germany. Instead of having a direct sale from the French subsidiary to the German subsidiary, you have the intermediate tax haven corporation sitting right in the middle. It tries to buy as cheaply as possible from one of its control units and sell as dearly as possible to another of its control units—another company in another country—to try to garner as much of the profits as possible in the tax haven country.

Now, assuming that France and Germany will allow some latitude in inter-company pricing, and this is usually possible, the Swiss subsidiary may divert a considerable portion of the profit to itself in order to avoid higher French and German taxes. The abuse, if there is one, in this situation, is at the expense of Germany and France and not of the United States. And during the consideration of Subpart F, many taxpayers complained that the United States should not concern itself with the avoidance of foreign taxes. Indeed, if the purpose of the legislation were to counter tax abuses, this argument would have carried great weight.

The United States was not attempting to be the policeman of the world in the tax field. Why should it be concerned with minimization of taxes abroad where the United States DISC would not suffer?

However, the position of the Treasury was that the question was not one of tax avoidance, but rather tax incentive for foreign investment, ultimately balance of payments. I do not mean to suggest that Subpart F was unconcerned with tax abuses. That certainly was an undercurrent.

However, I think it is useful for you to consider the extent to which the abuses to which Subpart F is directed are relevant here. I wish to point out that the problems that Subpart F was looking at were really directed to peculiar U.S. tax law. For example, a principal target of Subpart F was the use by American companies of holding companies in tax-haven countries to hold stock of operating subsidiaries.

The reason this practice was seen as an abuse was that under U.S. tax law dividends from foreign corporations are taxable to the U.S. recipient. By using a tax-haven holding company U.S. tax could be deferred or avoided on dividend distribution by having a dividend income come into the tax-haven corporation, essentially free of tax, then passed through to another foreign subsidiary, again without having paid any U.S. tax on the transfer.

By using this tax-haven holding company device U.S. tax could be deferred or avoided completely.

As I read your Government's White Paper, however, it is not proposed to tax dividend distributions to Canada from operating subsidiaries in treaty countries, quite unlike the U.S. pattern. This would seem to eliminate the need to be concerned about so-called tax-haven companies for such subsidiaries. It would not seem to be appropriate to describe as abuse the use of a holding company to receive the operating subsidiary's dividends if Canada would not tax the dividends in any event. In other words, what difference does it make to Canada if the foreign distribution goes to a tax-haven holding company and then back into another foreign subsidiary when, if it came from the foreign subsidiary in the first place back to Canada and back again to another foreign subsidiary there would not have been a tax applied. Again I am referring to foreign companies in treaty nations.

Your Government's White Paper indicates that it intends to use Subpart F type provisions to avoid diversion from Canada of passive type taxable income. This also has been of great concern to the United States. For example, again alluding to the point made by your chairman, a domestic corporation might seek to transfer an income-producing asset such as a patent to a tax-haven subsidiary to permit tax-free accumulation of royalty income. In other words, instead of getting the income back to Canada, or in our case the United States, on a royalty basis under a patent, the patent is transferred to a foreign tax-haven subsidiary and that tax-haven subsidiary receives all the foreign royalties, a diversion of income which would have gone to the United States.

While Subpart F may discourage such diversion, it would not be accurate by a long shot to say that it is the principal weapon in the U.S. Government's arsenal for this purpose.

Under United States tax law transfers of property such as patents to controlled corporations may be made without a tax. This is roughly equivalent to what is referred to as the roll over in the White Paper. However, where the controlled corporation is a foreign entity, the United States law requires an advance ruling from the Commission of Internal Revenue that the transaction does not have as one of its principal purposes the avoidance of the United States income tax.

This is referred to as a section 367 transaction. If the ruling is not obtained under section 367, the transfer becomes a taxable event at the point of transfer. The U.S. guidelines issued under these provisions indicate quite explicitly that transfers of income-producing property such as patents to foreign subsidiaries for licensing as opposed to productive use

are likely to fall afoul of the Governmer standards and will trigger a tax. The transer of the patent would give rise to an immediate tax measured, in effect, by the present value of the income to be diverted.

The White Paper, as I understand it, would go further than U.S. tax law by taxing all transfers of property and eliminating all roll over where the transfer is made to a controlled foreign corporation.

Under these circumstances, the concern in the White Paper as to diversion of income in this type of situation is difficult to understand.

Mr. Stanford G. Ross, Chairman of the subcommittee on subpart F of the committee on foreign tax problems of the American Bar Association section of taxation: Our guidelines do permit transfers of assets such as patents abroad if they are to be used in a manufacturing type of activity.

In other words, we distinguish the transfer of an asset abroad depending upon the use that is to be made of it. If the assets were to be used in connection with labour and other facilities so that the business operation abroad would generate a total amount of income, the contribution of one element to that by the transfer of a U.S. asset is not regarded as involving a diversion of income.

Therefore our position basically in the United States is that it is only in limited circumstances where the transfer of an asset abroad should result in immediate tax. Mr. Caplin's illustration is a classic example, the transfer abroad of a patent where the recipient is simply to collect royalty income and is obviously not doing anything with it. Another example is indeed the one inferred in the White Paper, a transfer abroad of a share of stock which is simply to be sold. The gain is something which we think you might as well realize in the two-step process of first putting it into a foreign corporation and selling it subsequently abroad.

However, except in specified instances we, in effect, allow a transfer abroad of assets.

Mr. Caplin: I would like to touch briefly on some of our experiences since we adopted Subpart F. For one thing, it became apparent that the 1962 legislation incorporating Subpart F had little impact on our balance of payments problem. The Government reluctantly turned to other measures. We went into a voluntary direct investment program. In 1968 this was made mandatory by the issuance of Foreign Direct Investment Regulations. While the United States was obliged to move from indirect to direct restrictions, it found that other tax measures could be used effectively to improve balance of paymeni primarily improving the tax treatment of foreign investors in the United States, which was an entirely new tack that we took.

In 1966 we enacted the Foreign Investors Tax Act. It was desinged basically to facilitate investment in the United States by foreign persons. Under the new law, the United States generally allows tax-free investment in United States securities or real estate. In other words, no capital gain on non-residents using our stock market, which I understand is quite contrary to the approach reflected in the White Paper. One of the consequences of the Foreign Investors Tax Act has been a contribution to the rapid development of offshore mutual funds, channelling European dollars into United States investment. Undoubtedly the United States balance of payments has been helped by the increased flow of foreign investment that has taken place.

With the election of President Nixon, a whole new Treasury team is in place, and a major proposal to emerge from the new Treasury is for a vehicle called the Domestic International Sales Corporation (DISC). The DISC proposal is a move towards an incentive system for improving balance of payments through increased exports. Under the proposal, a United States corporation engaged in export would be accorded deferral of United States income taxes. This is a monumental change in our approach. Not only would a foreign corporation engaged in export activities be free of tax, or Subpart F under the Subpart F exceptions, but now a United States corporation engaged in export is free of tax.

Senator Molson: How would that be defined, "engaged in export"? I suppose all really large corporations are engaged in export to some extent.

Mr. Caplin: A high percentage factor is used. We actually have part of the technical provisions here.

Mr. Ross: The basic technique is to put in requirements that have you organize your export activities in a separate subsidiary where as much as 95 per cent of the business will be export. The definition of "export" is basically very simple. It is where you are

handling goods whose ultimate destination, where the consumer is, is abroad. If you are moving goods out of the United States and isolate that, say, from your basic manufacturing activities in a separate corporation, then we have identified the export business and can give it this preferential kind of tax treatment.

Senator Molson: Would the tax be related to those particular transactions only, or is it tax treatment generally for the corporation?

Mr. Ross: It is tax treatment generally for the export corporation, but there are provisions that assure the export corporation a certain amount of return, which is quite generous. I think the basic rule is that four per cent of sales can be treated as earned by those export activities, so they give them a nice pot of earnings as an incentive to exporting.

Mr. Caplin: I mention this to illustrate part of the studies of our Treasury, which conclude that deferral of taxation on foreign earnings is basically a sound approach. It is felt that any attempt to impose additional taxes on United States companies operating abroad would be self-defeating, and would prejudice the position of United States business in world wide markets.

The ultimate conclusions from this process of experimentation have yet to be drawn. My personal view is that the Foreign Investors Tax Act was an extremely constructive achievement in providing incentives, in effect for non-residents to invest in the United States. In contrast, Subpart F has fallen far short of the attainment of its objectives. It is not clear what the new Treasury intends to do, although it has sharply criticized Subpart F, and I believe that changes will be proposed in the near future to the Subpart F operation.

Our tendency is to learn more and more on the traditional tax weapons that we have had and enumerated—reallocation of income among related entities, disregarded sham corporations, the various provisions mentioned by Mr. Phillips that you have in your law. To me as a former administrator this is the sound approach. The United States has articulated its regulations in this area in great detail, and even here we see a loosening up of the guidelines contained in the regulations, an attempt not to hamper legitimate foreign business. This philosophy is certainly being repeatedly stated by the new administration.

Before closing, I think I should touch upon the administrative complexity and underline that. As to these administrative problems under Subpart F, there is unchallenged agreement in the United States that it is among the most complicated provisions of our tax law, if not the most complicated. A professor of law in taxation, in a highly respected text described it as "a lofty plateau of complexity that the Internal Revenue Code had previously attained only an occasional subsections." He goes on to say that after that the statute shifts a large part of the burden to the administrators through regulations.

The Chairman: I suppose the loftiness comes from piling complexity upon complexity?

Mr. Caplin: That is right. I think we had some very fine minds at work on the provisions, but there are very few people who understand it, unfortunately. Not only has it coined a myriad of highly technical concepts of its own, but it draws upon various other concepts in the code.

The Chairman: Did not the drafters supply a dictionary?

Mr. Caplin: Well, we had some highly educated elite draftsmen from major universities and experts in the foreign field, with due respect to Mr. Ross, who worked on it. They as a group seemed to understand it, but here it is after eight years and, gentlemen, there are very few people in the United States who really can decipher these provisions, even the revenue agents, despite a very large expenditure on training. I was in at the beginning of that when we set up special offices and formed O.I.O. (Office of International Operation) experts in different parts of the country; we attempted this over a period of three years and then abandoned that approach. We found that the administrative personnel, some of whom are of very high intelligence, just had difficulty in understanding this and applying it.

The Chairman: It shows that a secret can be kept!

Mr. Caplin: That is right. The companies had difficulties. That has been shown by the organization testifying today, representing some of the leading companies of the world. I do not know how many millions and millions of dollars have been spent in trying to comply with these laws—the report writing, the data that has to be accumulated, the balance sheet

information. On wonders whether it is worth the candle when you get through. What is being gained in additional revenue? Are we trying to establish standards of international tax morality? Is this the undertaking of the United States Government or the Canadian Government? Must we allow legitimate business concerns to function with their proper payment of tax back home but not try to establish any standards so far as their connections abroad with other countries are concerned?

I raise these as questions because I think that in moving into this Subpart F area you could state the principle very simply as the White Paper does, but when you try to implement it by any fair or reasonable legislation you are going to find yourself in a morass.

The Chairman: You mean that you must have an objective, and presumably the objective that a country like Canada or the United States should have is to increase foreign trade. You have to decide what it is. Taxation is only one method by which you might do that. There may be many elements. If you have a system which proposes that if you bring foreign income from such operations back home without any tax credit there is not much encouragement, is there?

Mr. Caplin: That is right.

The Chairman: It is that simple.

Mr. Caplin: To recapitulate, that is the nub of the problem. It seems to me that after eight years the United States Government has been churning the void and producing very little cheese from a revenue standpoint. I think Subpart F has been only an interregnum type of provision to worry and concern people so as to make sure they dot their "i"s and cross their "t"s. From an actual revenue-producing provision I do not believe it has been productive.

The Chairman: I suppose the real additives, if we might continue the illustration, would be the Foreign Investors Act and also your DISC.

Mr. Caplin: That is currently being considered. In closing, let me express my great respect for the goals and standards which guided your Government in the preparation of the White Paper. It represents a monumental undertaking and has attracted world-wide interest. In the last analysis, though, the ultimate success of any legislation will depend upon fair and effective administration by your taxing authorities and upon understanding, acceptance and voluntary compliance by taxpayers. Your final legislative action considered here in this room will lay the foundation for the sound attainment of these ends.

Mr. Chairman and honourable senators, I would like to express the appreciation of Mr. Ross and myself for this great privilege to participate with you.

The Chairman: Are there any questions?

Senator Isnor: There was very much opposition to it in the 1962 legislation.

Mr. Caplin: The opposition was almost overwhelming. It led to severe compromise in the Senate of the United States, and even then opposition continued.

Senator Isnor: Where did that opposition come from?

Mr. Caplin: Primarily from the business community.

Senator Isnor: Due to the thought of unfair competition?

Mr. Caplin: Primarily this, and also it would not be revenue producing and would be extremely complex to handle, both by the companies and by the Government. The original proposal was to have a complete tax on all foreign-earned income, control of corporations operating abroad. This would automatically have the sort of phantom pass-through of income. The shareholders would be taxed on their proportion of that part of those foreign earnings with a foreign tax credit. That was then modified to relate primarily to the tax-haven operations. Then we had Subpart F finally emerging.

Mr. Bruhl: I think you understand what was going on in 1961 and 1962 in our country. You have to understand that the Government was totally committed against direct controls on foreign investment. Therefore, they felt that the tax law was the principal instrument to curtail the flow of American funds to overseas investments and to channel that into domestic investments. In effect, President Kennedy used to say that in getting the country going again the only instrument they had to work with was the tax law. They took it away from the normal purposes of tax law which are to treat income equitably and try to collect the taxes you need as simply as possible in order to achieve an economic end

which, by the way, most other countries in the world who have had similar problems have only been able to achieve through direct controls. However, within a very few years we found out that even with this enormous expenditure of effort in the tax area, this end could not be achieved and we had to resort to direct control. It was really an exercise in futility.

Mr. Caplin: As a footnote, I might add that a new Democratic administration, of which I was a part came in at that time and it was extremely sensitive to some of the criticisms of the past, such as the controls instituted in the New Deal. I think President Kennedy's impetus, backed by Secretary Dillon, was to keep away from direct controls and try to do it on a voluntary basis or through taxation which they felt would not have the stigma of direct limitation on foreign investment. Ultimately we came back to this and imposed these direct restrictions.

Senator Isnor: You are speaking as a Democrat now?

Mr. Caplin: Yes, I am.

Senator Macnaughton: I was going to say that if we can thank Mr. Caplin and Mr. Ross, certainly we should frame their testimony.

The Chairman: We will now hear the Canadian Export Association delegation. The president, Mr. McAvity, is going to make an opening statement and present his panel.

Mr. J. M. McAvity, President, Canadian Export Association: Mr. Chairman and honourable senators, we are conscious of your busy schedule and we are also conscious of the fact that your very competent advisors have prepared a summary of our submission for you. So my opening comments will be brief.

First, I would like to express the thanks of the board of directors of the Canadian Export Association for the very great honour of appearing before you and I would like to introduce our panel. You have their names and I would like to introduce them. On my right is Mr. Ellis, then Mr. Lees, who is taking the place of Mr. Craig who had to leave for Toronto on a noon flight for an appointment there and therefore is regrettably absent. Mr. Lees is a member of the tax committee. Then there is Mr. Bruhl, Mr. Kenna and Mr. Baylis.

I have, Mr. Chairman, a very brief résumé of the activities of our association which will put our submission in better perspective. We have a board of directors responsible for the administration of all policies of the association. In turn, they have an advisory board of governors comprised of some 55 top Management executives from a wide variety of companies. That main policy committee is responsible for policy decisions and recommendations put before the board. We have special advisory committees, such as the tax committee appearing here today, and others which deal with subjects such as export of commodities.

We have 150 to 200 experts from time to time participating in various activities.

I would like to stress two points. First, ours is not a special interest group but rather is representative of a wide cross section of resource development, manufacturing industries, banks, shipping and other service industries, which cater to the export community.

The second point is that a good percentage of our time is not directing efforts towards government but rather towards other people as well. We are not just a lobbying group. As an example, we are working with the Canadian Bankers Association, seeking improvements in export credit and financing arrangements; with ocean steamships and their conferences, seeking improvements in transportation and cost and service; with the Canadian Labour Congress—regular meetings, I would say at least one every few months, dealing with the need to improve productivity to maintain our competitive position.

In the past two years we have submitted no less than four briefs to the United States Tariff Commission and the United States Bureau of Customs, pertaining to matters involving the majority of exporters from Canada. Our principle objective is to foster the growth of export trade. This objective implies efforts to create and maintain in Canada the climate and conditions that will be conducive to the sustained growth of export trade.

As we have noted in our brief with some emphasis, one of the essential prerequisites is a climate that will encourage direct investment facilities to produce goods on a scale far greater than that needed for the domestic market alone.

A few weeks ago when our brief was being put together, our members felt serious concern about the future of exports, for some reason or another, and particularly at that

time they were concerned about what the authors of the White Paper described as a radical or a novel approach to tax reform.

Three days ago, the decision to free the Canadian dollar from its peg came as a surprise to everyone and one that certainly will have the effect of making life more difficult for all or certainly most Canadian exporters, perhaps impossible for some smaller Canadian producers with marginal exports and marginal profits on them.

We realize that this is no time or place for discussion of the circumstances that led up to this decision or of its impact on export performance. I want to mention it for two reasons.

First, whereas unemployment has been a major problem in many parts of Canada for some time, it now threatens to become a major problem on a nationwide scale, and one quite probably with important political implications. The second point and reason for raising this point is that the Government of Canada has not adopted the policy in past years, which is prevalent in certain other major nations, of providing special incentives to encourage exports when needed for balance of payments or for domestic economic reasons.

It seems that somehow Government action, or inaction in some areas, has been making life difficult for exporters for some time. I need only mention one example, the lack of decision to move ahead with labour policy and new legislation which would improve productivity and reduce work stoppages in important exporting industries and particularly our major ocean ports on both coasts.

It is to be hoped that the Canadian dollar decision will have the salutary effect of bringing into government policy considerations of all sorts the need to give consideration to the maintenance of Canada's international competitive position.

Our brief is divided into two parts. It is a sandwich, really. The opening and the closing general comments and conclusions are the views, and a good cross section of the views, of top management executives in our member firms. We have the feeling and we have stated it, I think, as well as we can, that the tax system must be compatible with, and the level of taxation competitive with, those prevailing in other nations, if industry is to be able to develop international operations.

We have stressed the fact that we have achieved a record of economic growth in the 1960s which has to a considerable extent been made possible by the expansion of exports from Canada, and we have stressed strongly that this climate must be maintained, which will make that possible.

We have not opposed anything in the sense of reform that has been proposed, but rather have seriously questioned both the method, the broad scope and the nature of the reforms, and particularly the timing.

We have suggested that at this particular time it is probably going to put the economy at risk to undertake the proposals as stated in the White Paper.

There is a long standing military axiom that a commander should not undertake any attack on any objective until he has firmly established himself on a firm base.

Given the economic problems which confronted Canada last week, and even more so today, we suggest that there is hardly sufficient evidence of a firm base today that would justify the move toward tax reforms as stated in the White Paper.

I should add that our members are also concerned about the timing of these proposals, because of Canada's economic needs, which we have expressed, and which we would like again to stress in the light of the evidence given by the gentlemen who have preceded us, because of the impending changes in the United States which cannot help but have serious implications for Canada. We have put our Department of Finance into the picture on DISC as far back as April 3rd. We have made recommendations to them that chapter 6 of the White Paper in toto should be held up, withdrawn or deferred, at least until some such time as changes in the United States become clear, both changes in Subpart F rules to encourage more manufacturing in the United States and in particular the DISC proposal itself.

I can state at this time that our recommendations to date have brought a rather disappointing response. It may take the Americans some time, and we feel that the tax reforms as proposed are important if and when these United States Proposals go through, both Subpart F and the DISC, we would obviously have to reconsider our position in the light of such developments.

I have suggested to one of the senior officials that it is very difficult for a small boy to jump from the top of the barn if he is put up

there. But if he stayed just on top of the rain barrel, it is not a very long step downward to meet the competition. I am suggesting here, sir, that we have this very much in mind, but that it probably would be unwise for us, in the light of the previous discussions, to elaborate further.

The sandwich, which comprises the second part, the meat in the sandwich, if you like, is the technical comments which have been prepared by nine of the tax experts from member firms of which this delegation is representative here today. Their principal interest lies in the proposals pertaining to international business in general and to foreign source income in particular.

I would like at this time to express thanks on behalf of the association again, sir and to let our tax experts proceed with the task in hand, to answer questions from honourable senators.

The Chairman: There are two questions I should like to ask you before we turn to the panelists. You spoke about a climate which was so conducive to expansion of export trade in the years that have gone by. Would you care to elaborate on that? What were the elements?

Mr. McAvity: It is possible that some of our tax experts can expand more clearly. However, I think the evidence indicates that foreign investors, and Canadian companies, too, have been expanding in Canada production facilities of all sorts, in resource development, and in an increasingly broad range of manufacturing industries, which would not have been done had there not been a climate which attracted those investors.

The Chairman: You were talking about a tax climate?

Mr. McAvity: Yes, we are talking about a tax climate. We mention that in our brief. The second point is that exporting from Canada generally has been at least on a competitive basis with exporting from most other countries in the world.

The Chairman: It has been an atmosphere in which multi-national operations could be carried on by Canadian companies.

Mr. McAvity: Precisely, sir. The honourable Mr. Sharp only a few years ago, when he was Minister of Trade and Commerce, drew attention to this on at least two occasions. He indicated that perhaps what our economy needed more than anything else was multinational companies based in Canada. This has been taking place.

The Chairman: Is it the view of your association that the proposals in the White Paper would militate against any great attraction for multi-national corporations?

Mr. J. G. Lees (Vice-President and Tax Officer, Alcan Finances Limited), Consultant, Canadian Export Association: Mr. Chairman, we believe that the proposals will militate against multi-national companies to the extent that we have an arbitrary withdrawal of the exemption for foreign dividends. Many of our Canadian multi-nationals have already established situations and, even if we do intend to change policy and have a vigorous re-writing a hundred or so foreign tax treaties, this takes years, and we need protection in the interim, and you are going to have the effect whereby Canadians will be reluctant to invest abroad until our treaty structure is established in full.

The White Paper suggests that they are giving themselves until 1974. So you have all of us very apprehensive in the kind of advice we are giving our senior executives in regard to foreign investment.

The second element concerns withholding taxes. A main feature of multi-national companies is to avoid double and triple taxation. Canada has generally been fairly good in this by allowing you to bring home dividends free of tax in the Canadian company. Canada's one weakness in this area has been that it insisted on negotiating 15 per cent rates of withholding tax so that you had the money coming in from abroad with the 15 per cent withholding tax, generally, and sometimes higher when we had no treaties—Italy and Switzerland being examples of that. This money would turn around and go back out of Canada to foreign shareholders and another 15 per cent chop would be made. So there were three levels of tax.

That has been Canada's weakness in this area. It has generally been got over by virtue of other advantages in the economy. Under the White Paper there is a suggestion for a flow-through which would improve this picture, which is of positive aspect, by getting rid of one of those layers of withholding tax.

Another feature of a multi-national corporation is that it has many subsidiaries in foreign countries and it tends to reorganize these. You swap a blind horse for a spotted

dog now and again. If you put a capital gains tax on those transactions, the multi-nationals will tend to freeze. They will be reluctant to turn over capital to more productive uses.

So I pinpoint the Exemption-by-treaty proposition and the capital gains proposition as negatives in the White Paper; and the flow-through as a plus. But the flow-through is a plus which does not equal the other two negatives.

Mr. M. Ellis, Member of Committee on Taxation, Canadian Export Association: In so far as the Canadian multi-national corporations are concerned—that is, those owned to a large degree by Canadian shareholders, of which there are very few indeed—integration as proposed would also create a further disincentive to these kinds of multi-nationals owned by Canadians to grow abroad.

The Chairman: On a previous occasion it was suggested to the committee that the White Paper proposals would be attractive to foreign corporations to set up subsidiaries in Canada. Have you any comment on that?

Mr. D. M. Baylis, Member of Committee on Taxation, Canadian Export Association: I do not understand the White Paper's reasoning behind that at all. The integration proposal which has just been referred to is a deterrent to non-residents to come and set up companies in Canada—whether or not they be companies engaged in multi-national operations all over the world. For them it is a definite deterrent.

The Chairman: Do you say that it would not be an attraction for the Canadian company setting up multi-national operations or that it would not be an attraction to foreign corporations to set up subsidiary operations in Canada?

Mr. Baylis: The latter, which in turn are multinational corporations. The integration proposal, by denying any kind of credit dollars to non-resident investors, is the most powerful deterrent one could devise not to attract this kind of corporation to Canada, and this type of corporation is a desirable thing to attract to Canada because it creates employment and attracts money to Canada and it attracts other business along with it.

The integration proposal is one of the main stumbling blocks to the future expansion of Canada's export business, generally.

The Chairman: Could Subpart F in the United States law and this proposed domestic international operation DISC live together and be mutually co-operative?

Mr. Lees: All I know about DISC is what I have read in press releases, but I notice that Mr. Caplin is still in the room.

The Chairman: Would you answer that question, Mr. Caplin?

Mr. Caplin: Mr. Chairman, Subpart F already has an exemption for an export trade operation, if it is conducted by a foreign company owned by an American company. DISC merely carries that one step further. It says that you no longer have to use a foreign subsidiary to get tax deferral in the United States; you can use a United States company and receive the same tax deferral.

The Chairman: You mean that you could have a branch operation?

Mr. Caplin: They would expect you to put in a new entity, but it now extends to U.S. subsidiaries.

The Chairman: Thank you.

Mr. Lees: Mr. Caplin's paper mentioned that if you had a foreign sales subsidiary that was accused of having passive income by virtue of selling to an affiliate in another country, it could escape the accusation so long as it reinvested in export assets. That way it got some partial relief from Subpart F. So long as it kept reinvesting the money in subsidiaries and did not bring the money back to the United States it could escape. There were all kinds of escape hatches.

The Chairman: So these things can live together.

Mr. Lees: I guess they can, but it sure makes life miserable sorting them out.

Mr. McAvity: Mr. Caplin could probably confirm this, but we have had information from a solicitor in Washington very recently that tax officials have stated on several occasions in the past few months that there is a definite attempt to change Subpart F in many ways in the next year or two in addition to the DISC proposal.

One other point I should like to mention in connection with the DISC, Mr. Chairman, is a rather ingenious scheme. If the United States had chosen to extend the privileges given to the Western Hemisphere Trade Corporation

on a global basis, they would have been contravening the rule of GATT to which they are a signatory. What they are doing here is to provide a system of deferment, on a fairly clearly defined basis, of United States tax until it is paid over to the parent company.

Mr. Lees: Mr. Chairman, I think in deference to Mr. Craig, for whom I am sitting in, I would like to make a plea which I am sure he would have made for the mining industry, and the entire range of raw material industries, and the tremendous influence they have had on the exports of Canada during the period in question. One cannot ignore the totally attractive package which Canada has put together to induce investment in this field. Perhaps the single most important question concerning exports and the new investments and the new capital required to promote them must be in the field of hard minerals and oils and I am sure Mr. Craig would have liked to have come down strongly on that point.

The Chairman: I don't know if you were here, Mr. Lees, when we were considering this important question of the extractive industries, but we had a suggestion from one very authoritative source that the tax haven for mining companies which the White Paper proposes doing away with should be retained, but with the suggestion that there should be a percentage of preproduction costs which should be charged against the income in the period of tax exemption, or that the amount of the preproduction expenses at the end of the period should be reduced by a defined percentage. Otherwise, the history of mining operations shows that where you have a tax holiday for three years, it is usually seven years before the company starts paying taxes. Now, do you think there would be too much erosion to the value of a tax holiday as an incentive if there were some such provision attached to the tax holiday privilege requiring a certain percentage, with that percentage perhaps being determined on the same amortized basis as they may be amortizing their debt money?

Mr. Lees: I will have to give my own opinion since I don't know Mr. Craig's. My opinion is that you should be more selective than that. We should find some way to give—I would favour an area of discretion in this particular area of incentives which would give finance and revenue—there is a committee which for years has sat on the question on whether you have a new mine, and I would suggest that you flesh up a committee like this and give them a very wide discretionary authority to extend exemption. Then, if somebody wants to open deposits in Baffinland or on top of Ungava somewhere, I think you should be prepared to be far more generous than your suggestion would allow because you are dealing in a harsh environment with heavy capital costs. Whereas it could be that even under your proposals in some instances the investor might be too generously treated in somebody's view, and I think it is an area that requires exercises in selective wisdom.

The Chairman: Yes, but you must remember that there is a charm in the expression "tax holiday" for the capital investor the same as there is in the word "depletion".

Mr. Lees: Certainly, and people trust in the law. There is this plus about it.

The Chairman: And therefore perhaps in order to maintain confidence we should not throw away those words.

Mr. Lees: I would agree. My own personal view is that we should keep the words, but give proper authority somewhere to expand these things within ranges appropriate to circumstances.

Senator Phillips (Rigaud): Mr. Chairman, in connection with this last question, the whole problem of ministerial discretion created reaction among the business community, lawyers and accountants and so on, and in 1949 we eliminated it completely, or we thought we had, and there were good many people who think that the reintroduction of the discretion would be dangerous because once you accept the principle of ministerial discretion, you immediately get the question of flexibility of tax laws which may carry the discretion too far in many directions. Now coming back to this question of incentives, personally I think we will have to abandon the lot and really get down to something of a consensus as to what the incentives should be. So I wonder how you would react to the personal conclusion on my part with respect to the tax holiday that the tax holiday should be based upon the necessity of pre-exploration expenses and the like being dealt with during the years of the tax holiday and not postponed so as to give a tax holiday in excess of the three-year period, and that with respect to depletion we take a flat number of years as being the period during which depletion will be allowed. It is true that in some instances

some companies will get more benefits than others, but in any event it should eliminate in the process some of the abuses which have been the subject of complaint on the part of the citizenry who feel that benefits are being given to the extractive industries to which they are not entitled because they get continuing benefits when they have gone away beyond the incentive inducement stage.

The Chairman: Is there anything you would like to add to the remarks you made earlier, Mr. Lees?

Mr. Lees: I think I am getting into some deep water.

Senator Phillips (Rigaud): We are not trying to put you into deep water.

Mr. Lees: I think a lot of industries have very strong economic interests on this thing. There are a lot of opinions, and I have given mine, and I think I would like to stand on that opinion which I offered that I think we need variability to meet varying circumstances if you are going to induce investments. If that is the name of the game, we need a law to meet the requirements. We have seen and looked at other countries which do offer such exemptions in cases of industries such as we have looked at, and they do, as you suggest, oblige you to take into your income over the years of exemption your fair share of depreciation and development expenses and such like, so it would not be unusual to take up that suggestion.

Senator Phillips (Rigaud): There seems to be a feeling that the suggestion that the extractive industries have a world area in which to move which is competitive to Canada is somewhat illusory and deceptive, that there are certain salutary benefits from making investments in Canada for both Canadian companies and foreign companies. But perhaps freedom of action competitive-wise is not as broad as has been presented to us. In other words, the extractive industries do not really have the facility to move around the world and to move into world markets generally. I am simply summarizing the answer to your point that there is a subtle feeling that the incentives should be maintained up to a certain point but not to the extent that they allow in terms of a three-year tax holiday an indefinite depletion allowance.

Mr. Lees: If you mean some reduction in present levels of incentive. I would endorse that.

Senator Phillips (Rigaud): You feel it depends upon a discretionary basis by administrative officials, is that it?

Mr. Lees: Subject to statutory guidelines to make sure that it is kept within bounds.

The Chairman: Mr. Lees, on the depletion aspect there are many companies, and I am thinking of oil companies, that are not able to make use of the depletion. We had the Hudson Bay people in here the other day and the first year in which they were able to make use of the depletion was 1969. Now, the basis for depletion, of course, is that you have to earn the money or the depletion does not mean anything. A suggestion was made here that maybe there should be a combination, a depletion allowance of some percentage of gross production income and then an earned depreciation, which is proposed in the White Paper. However, the allowance was recommended at $1 for every $2 spent, whereas the White Paper proposes only what is known as earned depletion, at $1 for every $3 spent.

The reason for the division might be justified because there are some industries that are resource in the sense that their material, such as iron ore and the tar sands are there. They do not have to explore, but simply go into production. Therefore they could not earn depletion under the White Paper, yet depletion is one of the attractive features of the format for attracting capital.

What would you think of dividing it? That is, instead of having the 33-1/3 per cent on net production income and every person who is in the business can take it, no matter what he does or whether he does anything, and the concept in the White Paper of straight earned depletion?

Should there not be a way in between that would take care of the different characteristics in the industry?

Mr. Lees: As it is not my business any more, I have not devoted my mind to it. The views of the Canadian Export Association are that the industries materially contribute to exports and certainly a tax incentive scheme of a somewhat generous scope has aided in this.

Mr. McAvity: In fairness to the mining industry representative who was compelled to leave, I would like to answer Senator Phillips.

Your proposals have a great deal of merit. However, I would suggest that before the white Paper is implemented consideration must be given to how the after tax return to the investor would look in the long term as compared to other countries.

I have two points with regard to the illusory impression you may have with regard to foreign investment by Canadian-owned or other mining companies looking elsewhere. One is that on October 1 of last year, based on a recommendation submitted by the Canadian Export Association in January 1967, there became available to Canadian companies a foreign investment insurance facility which would provide cover against all non-commercial risks. They were carefully defined, but pretty broad and included damage due to war, rebellion, insurrection, nationalization, take-over, et cetera, and, most important, transfer and convertibility risks.

Companies have moved out since that time to look at new sources of materials. This applies not only to metal mining and petroleum but I could mention asbestos in particular, where people are looking at a deposit in India. They would not have done this before the investment insurance was introduced.

As an aside I would ilke to make a second point, that six or eight weeks ago our association arranged a regular series of dinners for ambassadors representing Canada in foreign countries. We had Arthur Menzies from Australia.

At that dinner, of some three dozen senior executives, there were no less than three vice presidents of exploration of certain well known mining companies, who simply wanted to improve their relationships with the ambassador to Australia.

There is something to be feared. We have stated in our paper that the time has come, we feel, when Canada no longer has a monopoly on most of the important resources that have contributed so much to the economy.

Senator Phillips (Rigaud): We are on common ground.

Mr. McAvity: Yes, I think so.

The Chairman: You have indicated that some members of your panel would develop certain points.

Mr. McAvity: We have certain points in the international income aspect which we think are important. We would be happy to leave it to your discretion. We could answer questions or take turns explaining particular parts.

The Chairman: The reason for putting these three briefs together in this area is that they all seem to have the same subject matter.

If there is anything you wish to add, you have heard what has been said and the floor is yours.

Mr. J. P. Bruhl, Member of Committee on Taxation, Canadian Export Association: Mr. Chairman, you started the questioning by referring to the circumstances which led to the expansion of Canadian export trade and the multi-national companies stationed in Canada.

I would like to comment on the fact that Canadian multi-nationals and Canadian export operations do not exist in a vacuum. They compete with companies in several nations which have different tax laws. One of the primary goals in the new legislation is to ensure that Canadian multi-nationals and Canadian exporters remain competitive.

We have heard this morning about legislation in the United States affecting the United States multi-nationals and the United States exporters.

I would like to comment briefly on our European competition. Many European countries other than England do not employ the capital gains tax at this moment for corporations stationed in their countries. As a result, European corporations doing business in foreign countries are able to re-organize and have corporate investments without being concerned about eventual capital gains tax and credits.

Also, many European countries do not tax dividends as is presently the case in Canada when received from foreign subsidiaries. This would continue to be the case.

If Canadian companies are to compete with corporations that are subsidiaries of these European competitors and if we are subject to Canadian tax, either on deemed distributions of foreign earnings or in the case of a foreign subsidiary a tax on actual receipt of dividends, we may be subject to higher tax costs of doing business than our European competitors.

The Chairman: Or under the White Paper you may lose some of the incentives that caused you to locate elsewhere.

Mr. Bruhl: That is correct. From that point of view we should always compare whatever laws are enacted in Canada with those laws affecting our competition in major countries where we have to compete.

In addition to that is the problem that our companies in Canada are under a rather unique handicap. Canada and Australia today are the only developed countries which do not have something akin to a home market of more than 100 million consumers.

In Europe, through various trading groups such as the European Common Market and the European Free Trade Association, and home markets in the case of the Soviet Union, Japan and the United States, all these companies in other jurisdictions which are highly industrialized have this advantage.

In Canada and Australia we are also in the very difficult position of having a relatively small home market. In order to achieve the economies of scale we need export trade much more than other countries.

Senator Phillips (Rigaud): Which are the countries in Europe that have these advantages with respect to non-existence of the capital gains tax?

Mr. Bruhl: To my knowledge on the corporate level there is no capital gain tax in Holland and Belgium. I am not sure with respect to France.

Mr. Phillips: It is 10 per cent.

Mr. Lees: Many countries that do have capital gains taxes limit them to individuals rather than corporations. Of the major ones, only Germany and Britain impose any serious level of corporate capital gains tax. However, one never knows, if you took very carefully through all the treaties, whether particular major investments are not protected by treaty.

The Norwegians are good at this, being a small country with large exports and a most sophisticated treaty network carefully placed where their major investments are.

In all these countries the fine-pencil work is carried out closely with the ministries of finance.

Senator Phillips (Rigaud): Of course, that brings us to the area about which we have had these discussions in previous presentations, this whole problem of dealing with a matter domestically and internationally, and in itself raising the issue whether, if you were to have a capital gains tax or a special rate, it should be confined to a domestic acquisition and disposition rather than getting involved in our international operations, because of having only some 22 million population and being one of the great trading nations of the world, which puts us uniquely in a sense apart; there are very few nations with the population of 22 million who are still within the first five or six trading nations of the world. The question arises: should one recommend dealing with a capital gains tax, a revolutionary system, by simply saying we cannot get involved internationally in capital gains in respect of our multi-national operations, and if we must have it let us at least confine it to domestic capital assets.

The Chairman: You might deal with it, of course, in part by a low rate.

Senator Phillips (Rigaud): Yes, or at least to offset it by a low rate.

Mr. Bruhl: And roll-over privileges. The United States, by having favourable reorganization provisions, permits its domestic corporations to compete internationally.

Mr. Baylis: I should like to make one point with regard to companies engaged in the export business in Canada, by which I mean big companies. If the integration proposals are implemented, with many of these big companies who are presently enjoying benefits of section 28(1)(d) of the Income Tax Act and get their income tax exempt, the Canadian shareholders will either get no creditable tax or a very small credit, depending upon the company engaged in export having adequate domestic operations on which it pays Canadian tax. A large corporation engaged in exporting, and with some domestic operations, cannot be as attractive to a Canadian investor as a purely domestic corporation; it just is less attractive. That automatically comes in the minute those integration proposals go through. This seems to me to be a discriminatory finger pointed at all companies that have incentives at present, and with exporting companies the main incentive is section 28(1)(d) of the Income Tax Act.

To take the point further, all kinds of anomalies could arise. Suppose there is a subsidiary company in a tax-haven country like Nassau, where no tax is paid at all. Under the new proposals of the White Paper that tax-haven company would be taxed at 50 per cent, so that a Canadian investor in a Canadian company having operations or business in

Nassau would be given the luxury of full creditable tax, whereas if he had invested in another exporting company doing business in a treaty country he would be much better off afterwards by having invested in a tax-haven country where no tax at all is paid.

I do not know if I have made that point clear, but I think this is a very big deterrent to Canadian investors in export companies.

The Chairman: Mr. McAvity, we have decided that we are going to stand on the story as we have developed it in the international area. What is the next main point?

Mr. McAvity: We are at your disposal, sir.

The Chairman: No, I want you to pick what you want to deal with.

Mr. McAvity: We have a great many points in our brief. I leave it to our tax experts if there are any points they wish to dwell on. It is in the record; you have our brief and can read it.

The Chairman: And, of course, many of the points we have dealt with.

Mr. Lees: Mr. Chairman, I will be appearing with Alcan this afternoon, and I will just touch on one point that I think we would like to develop further this afternoon. Maybe Mr. Bruhl can help us with this European experience. This concerns the total level of tax in the economy, and the sense of having an efficient economy, the sense of whether simply on the budgetary side we are spending too much money, and are simply burdening our export industry with a social cost that is somewhat over their head.

To get Mr. Bruhl started, I would suggest that in Europe, if you look at the corporate rate structures and look for dividend deductibility, investment credits and investment allowances, their corporations do not pay taxes like 50 per cent, and Mr. Benson is simply wrong in the White Paper when he says that 50 per cent is the norm. Secondly, when you look at the managerial, entrepreneurial class, people who are hustling and trying to make this thing work, and look at the burden of tax they pay on their salary and their private wealth, you do not get the kind of picture we are having here. I believe this, and I think it is a factor. Personally, I should like to hear Mr. Bruhl's views on this.

Mr. Bruhl: Let me just briefly comment on the countries in which our company has subsidiaries, with which I am most closely familiar. I believe that in most of the European countries in which my company, Hunter Douglas Limited, has subsidiaries, the tax rate is substantially below the Canadian tax rate. We have substantial operations in West Germany, which has a split corporate income tax rate, so that the corporate rate is reduced if distributions are made to the shareholders. This is another way to achieve what the White Paper proposes to achieve through integration. The effective tax rate if you make full distribution, which most corporations do under these circumstances, is somewhere in the 34 to 35 per cent range. Holland is another country, with about a 43 or 44 per cent tax rate. This is without having resource to special incentives and privileges.

I think one of the reasons for the lower tax rates prevailing in some developed European countries is that a larger part of the tax burden is represented by indirect taxes. The tax on added value is frequently at a higher rate than the Candian federal sales tax. To some extent the different philosophy of placing tax burdens needs to be considered in giving credit for foreign income taxes. To do business in a non-treaty foreign country where the foreign income tax is low and taxes are raised through other means which are not based on income, the Canadian corporation is at a disadvantage. In a way it pays double tax. It pays its foreign tax burden partly through means of taxes other than income tax, and it is taxed once more on distribution of dividends in Canada, because the form of taxation to which it has been subjected abroad in Canada does not qualify for these special forms of taxation for which we will give tax credits.

I do not think I can comment in general on the question of the total percentage of foreign tax levied as compared to foreign gross national income. I have not made a study of this. I want to limit myself to reference to specific corporate income tax rates prevailing in specific countries with which I have had experience.

The Chairman: Notwithstanding the points which you make, Mr. Bruhl, we have been told you agreed that the climate which Canada has generated up to this time has been one in which you have been able to increase export trade.

Mr. Bruhl: As far as international companies are concerned, there have been some spe-

cific provisions in the Canadian export which have been very beneficial. One has been the ability to receive, like in many European countries, the tax-free distribution from foreign subsidiaries. This has made very simple, the administration of your total foreign business structure and it has permitted Canadian companies to expand without too much paper work. Another has been in the Canadian tax rule permitting Canadian corporations a deduction for certain expenses of supervising and directing foreign subsidiaries. I think one of the difficulties raised by the White Paper is that many of these provisions would be discontinued if the White Paper legislation is adopted.

Mr. Ellis: The real thrust of the association's submission is not so much that there were that many specific advantages in the Canadian tax system, which were not granted to competitors based in other countries, but that the Canadian tax system has at least not prevented or inhibited the growth of exports. On the other hand, the White Paper, as far as we can determine, will inhibit this growth. In this context it is more a matter of relatives than absolutes when the statement was made.

Mr. McAvity: Unless the tax experts have any further points to make, I would like to sum up what I feel is in their minds, having heard them talk about this for the last many months. This would be to preserve a system which will enable Canadian companies to develop internationally.

As Mr. Caplin pointed out earlier, it is not only the tax climate in Canada which to a very large extent determines the decisions to invest, create jobs and build the economy in Canada, but also the package of foreign and domestic tax all put together. If there is one thing which we would like to see preserved most—there are others—it is the right for Canadian companies to establish with bona fide business commercial operations. They should be permitted to come in tax free as in the past. I would like to make it very clear that we are not opposed to reforms per se, but rather are seriously concerned about the impact on trade, direct investment, technology and the human skills this country needs to develop exports in the years ahead.

We have recommended that changes be taken which would present less risk to the economy and that they be achieved over a more gradual period in relation to the growth of the economy and weaknesses and abuses. We would be glad to help in finding ways and means of making our present rules and regulations fit.

We are indeed grateful for the privilege of appearing before you.

The Chairman: I suggest that we should print as an appendix to the proceedings today the printed statement of Mr. Caplin, which was provided for us this morning.

Hon. Senators: Agreed.

The committee adjourned until 2.15 p.m.

Upon resuming at 2.15 p.m.

The Chairman: Honourable senators, we have two briefs this afternoon. The first is from Aluminum Company of Canada Limited (ALCAN). Appearing for ALCAN we have Mr. Leman, Mr. Lees, Mr. Place and Mr. Collins.

Mr. P. Leman, Executive Vice-President, Smelting; President, Aluminum Company of Canada Ltd.: Thank you, Mr. Chairman. Honourable senators, we are glad to have this opportunity to comment a little on the views we expressed in our written brief to the committee. Quite a few of the points we make in our brief were well covered by other witnesses this morning and therefore, in order to save your time, I do not wish to go over that ground again.

However, we do wish to re-emphasize a couple of points we made in our brief. The first one is that what we presented to you in our brief is strictly an exposition of what the White Paper reforms would do to ALCAN as a corporation. We have stayed pretty well out of the controversial items. We have not wished to deliver a sermon to the Canadian nation as to how they want to live or use their resources. We tried to be as factual as we could, in explaining the effect on ALCAN. We have not tried to invent a new system but we have suggested some ways in which the proposed system could be amended or adopted so as not to injure ALCAN.

One point we have mentioned in our brief, which I think is valid, is that corporate taxes in Canada, compared to other countries where ALCAN is engaged in operations, are higher. We believe that the White Paper comparison is not quite correct, and that in general corporate taxes in Canada are higher than in other developed countries.

We also made the point in our brief that the personal taxation proposals, particularly for the middle income groups which will include your workmen within the matter of two or three years, with a bit more increase in their remuneration, adversely affect our middle management groups to the point where this could be harmful to ALCAN as a multi-national corporation.

On the question of personal taxation, we have been hearing for 25 years about the comparison on a hypothetical basis between the level of income tax suffered by the individual in Canada and the United States at various levels of income, but always on the basis of certain assumptions. In the White Paper they made certain assumptions, they presented a comparison, and then certain other firms, including in particular Price Waterhouse, made different comparisons based on other assumptions. There are always assumptions, they are always talking about Joe Doaks or somebody like that. We were so interested in this that we have made comparisons based on living people.

The Chairman: Good.

Mr. Leman: Therefore, we would like, with your permission, to send you within a few days, as an appendix to our brief, the result of those comparisons with living people. We could give you those figures. They were not ready at the time the brief was prepared. We have them now and have them in better shape.

The Chairman: Would you care to state now in a summary way what the result might be?

Mr. Leman: I think those figures will prove that, beginning at $15,000 and up, the Canadian personal income tax is much heavier, and increasingly so as you go up. Our comparisons stop at the top income we compare here is around $30,000 to $35,000 a year.

Senator Molson: What is the lowest?

Mr. Leman: We go down to $10,000 and up to about $34,000 here and as you go in that range the Canadian tax is progressively heavier to a point where it is nearly double the U.S.A. tax.

Senator Beaubien: Are they married people in most cases?

Mr. Leman: Most of the people are married and we will show you the personal exemptions they were getting, we will show whether they owned the house, what the mortgage on the house was, what the mortgage interest was, what the various deductions were that they were getting, etc. So you will get a good view of how those people live and what sort of people they are. I would not call it a complete statistical sample of the population. I do not mean that. But they are people who are working for ALCAN.

The Chairman: It sounds very much as though it would be in line with what Massey-Ferguson told us. They gave us a grouping in about the same categories and the difference has gone up almost to the point of double. So your figures may be fairly representative.

Mr. Leman: I hope so, sir, but at least what I think their value is that they are not hypothetical cases. These people breathe.

There is one more point on which I should like to touch. We should like to send you also a very short supplementary brief on a point which Mr. Lees mentioned this morning and which relates to this proposal in the White Paper for the flow-through system for a foreign withholding tax, to avoid what in some cases can be a triple taxation of income.

We would like to indicate how we believe this could be adopted, because it could be helpful to a multi-national corporation—how this could be adopted under any system, whether the White Paper proposals are adopted in substance or are not, in either system we think this would be helpful.

The Chairman: We will be getting that shortly?

Mr. Leman: This is practically ready. The weighting has to be improved but it is something I believe we could send within a week.

Lastly, as to the range of importance of the points. We talk about the effects of the White Paper on ALCAN, as to the level of taxation that ALCAN would suffer, and we make suggestions for improvement. The most damaging one, if it were not fixed up, would be this business of calling Aluminum Company of Canada Ltd., the largest operating subsidiary in our group, a "widely-held company". This would be extremely damaging and, if you have read our brief, you will see that it is a technicality. The Aluminum Company of Canada has some preferred stock outstanding, but no common stock. As the White Paper proposals are drafted or written, this would make our subsidiary a widely-held company and the impact of this is tremendous.

With those few points, sir, I would rather open it up to any questions that honourable senators may like to ask us.

Senator Carter: I wonder if the witness would elaborate on the last sentence and give some illustrations about the impact. He says it would be tremendous. Could he enlarge on that a bit?

Mr. Leman: Are you asking me if I could give an idea of the dollar impact?

Senator Carter: No, no. You said it would have a tremendous impact. In what way? In various ways, apart from the dollar increase?

Mr. Leman: It would raise our taxes payable by a very large amount, in the millions of dollars. I do not remember the exact figure but it is very very heavy and we do not quite understand the concept of calling ALCAN: Canada a "widely-held company," because it has outstanding in public hands strictly a redeemable sinking fund preferred stock. This is not a permanent equity in the subsidiary, and it closes the door to the parent company treating ALCAN: Canada as a partnership under the system.

Mr. J. G. Lees, Vice President and Tax Officer, Alcan Finances Ltd.: Perhaps I could elaborate to honourable senators why this happens. The Aluminum Company of Canada is a major subsidiary of ALCAN Aluminum Limited and for reasons of raising money through debenture debt issue we placed under it our main foreign mining subsidiaries, some other operating subsidiaries in the Caribbean and our American fabricating subsidiaries. These companies make good money and pay dividends to Canada, which is the way people are supposed to live, and this money is in turn distributed through the Aluminum Company of Canada up to ALCAN Aluminium, where it is used to pay dividends to ALCAN's shareholders. Because of the fact that in the order of 25 per cent of the Aluminum Company of Canada's income to foreign sources it will not be able to pay a fully tax creditable dividend under the proposed system at a high dividend pay-out rate. We measured the last three years and pretended the law came into effect in 1966, and we had to live with it in 1967, 1968 and 1969. In these years our tax payments would have increased by some $15 million because we do not get a full creditable tax. The reason we do not get a full creditable tax is that the Aluminum Company of Canada is called upon to make a high rate of pay-out. If we were obliged to live with this law and it was not changed and if we wished to avoid these taxes, it would force us to minimize and reduce the dividends paid by the Aluminum Company of Canada and keep the cash at that level whence it might not get the most economic use for our company and for our shareholders. Otherwise, in Alcan Aluminium's hands you have to pay out these large sums of tax money, and we can show that if you wish to pitch our inter-company dividends at what we consider a proper business level, it would over the years have cost us a lot of money. I believe that something like $10 million a year is not unusual.

The Chairman: By the way, is this $15 million that you mention per year?

Mr. Lees: $10 million per annum is the actual figure we picked up in one year. It was lowered to $2 million in another year and yet in another year it goes to zero because we cut down the dividend and did not really need so much money that year. We reduced the dividend and there was adequate creditable tax. So it is a variable and the extra tax payment in our estimate goes from zero to ten million and back.

The Chairman: But Alcan has many subsidiaries.

Mr. Lees: Many other subsidiaries.

The Chairman: Well, subsidiaries in relation to Alcan because Alcan is in itself a subsidiary. Some of them, for example, your bauxite development, is down in the Caribbean. What is the climate there? Have they still got the tax holiday down there or have you gone beyond that?

Mr. Lees: We are gone beyond that.

The Chairman: You are now subject to regular tax?

Mr. Lees: Yes.

The Chairman: What is the rate?

Mr. Lees: 40 per cent in Jamaica and 45 per cent in Guyana, and they have both invited us back to discuss tax rates.

The Chairman: I am sure that does not mean lower rates.

Senator Molson: On page one of your brief, at (c), you say "Alcan's total Canadian tax in 1968 amounted to approximately $58 million."

What are those taxes? Do they include all taxes such as on real estate?

Mr. Lees: I would say of that sum, $45 million was income tax, and $8 or $9 million was real estate tax and then sales taxes, and then we have another large figure that we paid to the Province of Quebec for royalties on our hydro installation.

Senator Molson: That includes all taxes paid?

Mr. Lees: Yes, sir, they are all added together.

The Chairman: I am trying to figure out, Mr. Lees, the specific areas where the White Paper cuts against you. Is this on the bringing in of foreign income?

Mr. Lees: Let us pick some sensitive areas. There is one that will become a permanent problem to us. We own a 22 per cent interest in a smelter in Sweden and the Swedish Government would not let us increase that fraction to 25 per cent. The present law legally permits us to arrange this holding so that we do not pay income tax in Canada. Under the White Paper, if the passive income proposals and the treaty proposals are taken together, the present arrangement would not be permissible. And since we only own 22 per cent, we would not get credit for the corporation tax paid to Sweden by this company; we would be treated as a portfolio holder, just as if we were holding a few odd shares on the New York Stock Market.

The Chairman: That is assuming that Canada can renegotiate a treaty with Sweden?

Mr. Lees: No, sir, this is in the White Paper rules, because if we do not own 25 per cent...

The Chairman: You are misunderstanding me. What I am saying is that in order to get any benefit under the White Paper, you would have to own 25 per cent of the voting shares of the foreign company, but in order to get the 25 per cent rate under the White Paper, that is only allowed in connection with a treaty country.

Mr. Lees: That is right. But this is a treaty country.

The Chairman: It is now, but how do you know they will be able to make a new treaty. This is just an assumption.

Mr. Lees: This is a risk wherever there is a treaty, but this is one area where we have a major concern. We think this is going to be true for many Canadian exporters. If you cannot get 25 per cent—and it is a good thing and you should take what you can get, we think there should be encouragement for people to take down to as low as 10 per cent and still be able to get at least a tax credit arrangement.

Another problem in this area deals with India. India normally has a very high rate of tax and our smelter there reinvests heavily, quite often with government finance, and Canadian aid assistance. I believe we had some export-import Canadian aid assistance. Under Indian Tax law, this Company will pay no tax in the next few years because of incentives, investment credits and things like this. But under the arrangement of our holdings and the India foreign exchange position, our dividend stays at a level rate and it is a very rewarding dividend. The Indian subsidiary would have paid no tax for ALCAN to use as tax credit on this dividend, and we do not think there will be a treaty with India to qualify the dividend as exempt. It would cut the liver and lights out of that investment for a while and it would frustrate the Indian Government. Then in Brazil, we have a very large and thriving group of companies. But because of the peculiar structure of Brazilian law and the way that the Brazilians raise money, we end up with a multiplicity of companies. And as Mr. Caplin explained this morning in his explanation of Subpart F, we have a nightmare to try to honestly disclose and account for all these companies and then to make reports to the Canadian Government on them. Some of them we try to forget that we even have them because they are purely a fiction of Brazilian law. Since there is no treaty with Brazil, we feel very apprehensive that our position there would be damaged for the worse under the White Paper passive income rules, and the dividend exemption by treaty business, for example.

The Chairman: To what extent would the passive income rules in the White Paper affect you? I suppose it depends on how they are interpreted.

Mr. Lees: Yes, and whether the dividends passing from one little company to another ought to be considered as passive income or not, or would they be regarded as some device to avoid Canadian tax.

The Chairman: They are Canadian sources of income.

Mr. Lees: Yes.

Senator Molson: In Sweden, who has the other 78 per cent?

Mr. Leman: It used to be the public, but a year ago or fifteen months ago, a large substantial Swedish concern called Grangesberg has taken control and so I think that by this time they have rounded up all the other shares.

Senator Molson: All the other shares?

Mr. Leman: I think so, except for a very small minority.

Senator Molson: In this case it has obviously been done with the agreement of the Swedish government then?

Mr. Leman: Yes.

Senator Phillips (Rigaud): Have we dealt with the basic question of integration? I notice in part II you say that integration needs to be modified and then you proceed to (a), (b), (c). Do you accept the White Paper concept of integration as being desirable, subject to modification? Or are you objecting to the whole concept of integration as contemplated by the White Paper?

Mr. Leman: Basically we say that Alcan can live with it, provided certain modifications are concerned. We are a little worried about the differentiation of closely held and widely held corporations. We have a specific widely held problem in the Alcan situation, which I described a few moments ago.

Senator Phillips (Rigaud): But you have the unusual suggestion that integration might be lived with provided you get a specified corporate rate below 50 per cent, and you say that if the corporate rates of taxation are reasonably close to that of other competitive countries you could live with the concept of integration. It is pretty difficult to develop a taxing system where the efficacy of the system depends upon the tax rates in other countries. Surely the integration system is either sound or unsound?

Mr. Leman: We express that hesitation in our brief by saying that we are a little afraid that the integration system will tend to keep the corporate taxes up to the 50 per cent level because of the rigidity probably of keeping the personal rate up to 50 per cent.

Senator Phillips (Rigaud): Most of the people making representations here are concerned not about the 50 per cent level; they are concerned whether that is realistic, and whether any assurances on the 50 per cent level from anybody makes any sense, having regard to what may be the needs of the Government in the future. In other words, the rate of corporate taxation may exceed 50 per cent, depending upon Canadian needs. What I am getting at is this. The great number of taxpayers in this country—and speaking for myself I am in agreement with them—regard the integration system as illusory, inefficient, inept and not capable of realistic administration. Mind you, as I say, at this stage senators speak for themselves and not for their colleagues. I should like to know from an important company such as yours, quite independently of the effect on your own company: do you believe it is desirable to have in Canada a system of taxation based upon the concept of integration under the White Paper?

Mr. Leman: As Paul Leman I would say I fully agree with you. I do not like it; I do not believe it will work well, but in our brief, I again emphasize, we only wanted to be as factual as possible and say what can Alcan live with and what it cannot live with. We did not express a whole nation concept of the system. We said we can live with it provided these things are taken care of.

The Chairman: Integration is a specific item under the White Paper. The moment you say you can live with it and then immediately say, "But there are some things that we don't like, or prefer not to have in it, or that makes it difficult for us", are you not taking away from the plan of integration, or the proposals as stated in the White Paper?

Mr. Leman: We have suggested how the system could be amended and not be destroyed. If the Canadians prefer to have the integration system, we think it can be fixed up so as not to do too much damage to a multi-national corporation like Alcan.

The Chairman: But that is relative, is it not? We are told in the White Paper that the loss of revenue in bringing integration into force would be about $234 million. If you do any whittling at it, is that minus likely to increase or decrease?

Mr. Lees: We think the whittling we have done is very modest against that $230 million, because they probably had no way to esti-

mate in the figure of $230 million the kind of anomalies we have brought up. When we started counselling among ourselves on this problem, we took the White Paper literally; we took the minister's statement that anybody who wanted to knock this paper had better be prepared to defend himself on the grounds that he is designing his own system, and you are not free to make a lot of remarks without making some positive contributions somewhere.

The Chairman: I have news for you, Mr. Lees. There is no such rule in this committee, and the minister does not speak for the Senate.

Mr. Lees: In our assessment we thought that in the White Paper's criticism of the existing system there was an item which we felt, as a multi-national company with a large foreign income flow, we were obliged to take seriously. That is this question of giving the taxpayers a universal 20 per cent tax credit whether or not the Canadian company paid a dime's worth of tax. We said to ourselves: do we care to stand up and defend this when somebody may be questioning that Alcan in fact does not pay any Canadian taxes? In fact, as you can see, we pay a good bit more than we think is our share. However, we did not care to put ourselves in the position of defending the system, because we know that it is possible in some years, due to strikes, sales declines, natural hazards, that we would not pay much Canadian tax, but the foreign income would contribute materially to our dividends. We therefore took this route—and I must say with a little bit of give and take among ourselves—that it is better for us to point out that if over-all this point is taken seriously by the Government and integration is concluded to be the way to provide tax credits to Canadians as an incentive to buy Canadian stocks without giving them credits for the income which never paid a Canadian tax, then we can live with the system—mind you, bearing in mind that Canadian factories and Canadian smelters should be allowed to be taxed at competitive levels.

The Chairman: You are measuring integration in the White Paper by reference to the present tax credit, and the implications of that. If you look at it on its own merits, without comparing it with anything else, for instance a multi-national company would have problems in bringing home dividends.

Mr. Leman: We tend to conclude as a matter of opinion rather than fact that for instance, the United States would consider the integration system as discriminatory vis-a-vis the American shareholders in Alcan. In brief we warn that perhaps if we negotiate a tax treaty the United States would request some same treatment as had to be given by France, for instance.

The Chairman: Then the two and a half years in which you can make a pay-out with creditable tax, you can live with that?

Mr. Leman: We asked for more time than that.

Mr. Lees: We asked for seven to ten years.

The Chairman: So this is another aspect of the White Paper proposal that goes on the negative side.

Mr. Lees: But, all the way through we have tried to design our paper and, as you can see, we took a lot of paper to find ways to adapt to it. If you wish to have an integrated system with a capital gains tax, here are our suggestions whereby a multi-national company can adapt to this system so that the spirit of it will be retained and a good bit of flesh on the bones will be left and companies such as Alcan will not be driven out.

Senator Phillips (Rigaud): It is because you are such a serious company that we are pressing you on these points. You say that you can possibly live with integration if the level applied in most industrial countries was around 45 per cent. Suppose these industrial countries had a burst of prosperity and got down to 25 per cent as their average corporate rate. Do you think it is realistic to accept a system of taxation pursuant to which you could come back to Ottawa and say that because in most industrial countries the corporate rate is 25 per cent, you can live with an integrated system that is contemplated by the White Paper, provided the corporate rate goes down to 25 per cent rather than 50 per cent? I am just directing myself to the dangers. I can see your motivation. If government says we are to have an integrated system, then let us have it on a basis that we, as Alcan, can live with. How can you live with something that involves such fundamental variables?

Mr. Leman: The way we express it is shown at the bottom of page 2:

The three disadvantages are as follows:

a) integration is likely to make it impossible for Canadian corporation taxes to be reduced to internationally competitive levels unless the scheme is amended.

We expressed that doubt you have just expressed yourself. We say that we think integration will be difficult to live with and we believe that it may prevent Canadian corporate taxes to go down to competitive levels.

Senator Phillips (Rigaud): If the conclusion were that integration is a hopelessly involved system, would you quarrel with that conclusion as an important taxpayer in this country?

Mr. Leman: We would rather not have the system.

Senator Phillips (Rigaud): You would rather not have the system. May I go to another question, Mr. Chairman?

The Chairman: Yes.

Senator Phillips (Rigaud): Going back to Roman numeral II, item 2, and dealing with capital gains you say:

> Capital gains tax should be levied on only half of all long-term gains as in the U.S.A. and generally not on gains on a deemed realization basis.

Do I read that to mean that because you say "generally not on gains on a deemed realization basis" that there are instances which justify taxation of so-called capital gains, even though such profits are not realized?

Mr. Lees: Senator, we phrased that clause in connection with the problem of persons leaving Canada. I must say that one of the best scrimmages we had in writing this paper was on this very question of departure from Canada. We have many employees who are international and many people who retire from Canada. Mr. Place can speak about this to us.

Some of us felt that people who are Canadians or who have lived their substantial working lives in Canada and retire to Tampa, Florida, never return again and that they should be expected to pay some kind of a capital gains tax to Canada. You have two choices, the American style of letting the flag follow them and when they sell, Canada by treaty negotiation or something else, gets the first right to tax that sale. This is a treaty problem. You can tax them when they leave on a deemed basis and find some way to let the Americans give a credit for this through treaty mechanisms, should they ultimately sell the asset. We think there is a problem but, however, we do not all agree.

Senator Phillips (Rigaud): We know the problem, but is the inference from your consideration of the problem that the load should be borne by those who are not obliged to leave the country and who do not want to leave it and who should therefore be exposed to a payment on the tax of the non-realized capital gain? That is how I read your statement, Mr. Leman. What is the meaning of the expression "and generally not on gains on a deemed realization basis"? I am only putting these questions to be instructive.

Mr. Leman: That may be a weakness of the summary. You were reading from our summary. If you would please turn to page 4 of the main brief, item II, "The proposed new system of taxes on capital gains". To go back specifically to the point you have raised, we say under paragraph (b):

> it is very important that provisions be included so that tax is levied only when the capital gains arising from any transaction have actually been realized. In some cases such as expropriations and reorganizations it may be a considerable time before any gains are realized.

It may be a bit of a weakness in the summary that the word "generally" slipped in.

Senator Phillips (Rigaud): I think you have answered me, Mr. Leman, other than the statement that the two paragraphs are inconsistent.

Mr. Lees: On the top of page 6 we mention about transfers in and out of Canada. The problem when organizing our brief was that some of these things tracked over each other. We find that this proposal is particularly onerous and we do not favour taxation on the deemed realization basis. The paragraph goes on to say:

> If such a system is adopted however it is suggested that Canadians who go temporarily to other countries and foreigners who come temporarily to Canada be exempted...

In our technical appendix we go into greater detail and we point out that there is some argument for a tax.

We do not like deemed realizations at all, but you do have the case of a Canadian who leaves this country, and how you are going to tax him. There may be a case for this if there is proper protection of the treaty. I think the word "generally" in the summary means that we do not think deemed realization should be taxed at all except possibly in the case of the Canadian leaving Canada permanently.

The Chairman: Why do you pick on him?

Mr. L. H. Place, Secretary, Alcan Fiduciaries Ltd.: This is an area where there is some measure of a difference of opinion between the members of our committee. I certainly do not enthusiastically subscribe to Mr. Lees' views.

The Chairman: A man may finally, after spending a fruitful life here, gather up whatever he has and decide that his health is such that he wants to go where the climate is better. He gathers up whatever bundle of assets he has and away he goes. You say that at the border all of his assets should be evaluated on a deemed basis and he should be levied a capital gains tax. I say why? What has he done?

Mr. Lees: If you thought that he was only leaving for his health and his assets were not so much, you would probably say all right. If you strongly suspected that his health was perfectly sound then you might begin to say that you are going to tax him because he is trying to avoid tax.

The Chairman: Just deal with the principle. You are dealing with a particular case, but what is the principle?

Mr. Leman: The only principle involved is if you want to tax capital gains, you might be afraid that you will never tax some if the people who are close to realizing capital gains leave the country. That is about the only principle.

The Chairman: Suppose there was a loss? What is he going to write if off against?

Mr. Lees: Precisely.

The Chairman: It should work both ways.

Mr. Lees: Yes, it should.

The Chairman: I still want to get back to the principle.

Mr. Lees: If you are going to have a capital gains tax you must do it fairly. The next problem, which is one of our cardinal points, is that Canada is a country with a harsh climate and it is very normal and not unusual, particularly for people with some wealth, to retire elsewhere. I think that the people in the Finance Department are worried that Canada materially loses on the balance of payments or balance of tax, because some of its better-to-do citizens are retiring to the United States or the Caribbean. They feel that they need a tax answer to this because a good bit of the capital gains will never be realized in Canada. Without trying to punish somebody or do the wrong thing, how do you look out for the maple leaf interest in the thing?

The Chairman: You confuse the situation, because you are now talking about capital gains, whereas a few minutes ago we were talking about deemed realization. Do you say they are synonymous?

Senator Hays: You also define "capital gains" and it may be that you define it differently.

The Chairman: It is implicit in the word "gains", is it not?

Mr. Lees: That is right.

The Chairman: And anything else which may amount to gains, it does not exist. If they want to carry a passport to protect their assets, it may be we can write that into the law.

Mr. Lees: The International Chamber of Commerce made a submission on this and it is the very point that you make. Every time you get into this, it is very well to tax gains but it is extremely difficult to recognize and allow losses.

Senator Phillips (Rigaud): Is not this the time, possibly, to get into this and fix the point, that the issue on taxation is not the taxation of a person who leaves the country with capital gains but whether he gets protection of our flag by carrying a passport, because taxation is based on residence, but nationality is not necessarily based thereon. There may be something to the point that if a person leaves a country and insists on getting the full protection of Canada with a passport, that there ought to be some change.

That is why in the United States taxation is based upon nationality rather than upon resi-

dence and the problem of domicile. There may be something to the point that at least we in this country—I do not think we should do it—but I do say it that we at least ought to give some consideration to that question because while we never had a capital gains tax, the question of taxation of income related itself to working in the country and that sort of thing, or dividend or interest income, if a person left the country, there would be a need to have at least a withholding tax to the extent of interest and dividend payments and the Crown would get some money. But when you introduce a capital gains tax, the laws of the game change.

I am merely suggesting that this is a reaction against allowing easy treatment to the person leaving the country, where others who stay in the country have to bear the burden—why not reach him before he leaves, either on a realization or non-realization basis. It probably would cover the equities of the case, in the manner I have indicated, rather than in the manner suggested.

Mr. Place: We do not like this kind of out-of-town membership concept, if I may use that expression, with respect to the reference to continuing to pay tax, and I think it would be unfair if it were applied in only this one field. You have a Canadian going to the United States and if they are going to be taxed on deemed realization, what happens when they actually sell those assets? The United States is going to say that they will have to pay the tax to them, unless it happens in the same year, the man who has paid his deemed realization in Canada, cannot offset that against his subsequent United States tax.

The Chairman: As deemed realization? Where do you find that in the United States tax law?

Mr. Place: There is no deemed realization.

The Chairman: How do you know it could be offset?

Mr. Place: I say it cannot be offset.

Mr. Lees: If it is thought that we are speaking in favour of this thing, we are on the wrong side of the question. We found that we were not going to criticize this out of hand, because it was a problem which we did not have any better answer to ourselves, so all we said is that if you are going to have deemed realization let us leave our international transfers for employees alone, do not apply it to the foreigners in our employ who come temporarily to Canada in our service. Let us try and limit it, if we have to do this sort of thing, to Canadian citizens making their final departure. We are not proposing this, we are just trying to pick up the genuine problems in the thing and say, do not hurt here, do not touch this. If you never enacted the proposal, we could not be happier.

The Chairman: I suppose, Senator Hays, this would be a very apt place for your question which you put to the chamber of commerce people when they were taking this attitude "we are against capital gains but these are the suggestions we have to make"—I thought your answer was very apt.

Senator Hays: I said: Thou shalt not commit adultery, but if you do, this is the way to do it.

The Chairman: This is about the presentation you are making.

Mr. Place: I think so.

The Chairman: On page 4 of your brief, Mr. Leman, you have really dealt with integration. You deal with it in this way by saying in paragraph (c):

> If integration is adopted as proposed in the White Paper without the revisions described herein which Alcan seeks, Alcan's effective corporate rate of tax will increase significantly.

Mr. Leman: Yes.

The Chairman: That is a solid basis on which we can conclude that integration in the form in which it is proposed in the White Paper, you do not support.

Mr. Leman: That is definite, sir.

The Chairman: Then you go on and give reasons why.

Mr. Leman: Yes, sir.

The Chairman: And they are all solid, logical reasons.

Mr. Leman: Yes.

Senator Hays: I have a question. Regarding this report that you have of your employees in Canada and the United States, the comparison in the total tax bill, if a man is earning $20,000 or $10,000, do you in this exercise—I believe the figures you use are the figures now but not the ones that there would be?

You have not projected it under the White Paper?

Mr. Lees: These are the present figures, actually based on 1969.

Senator Hays: You have not looked at the proposed rates. I do not know whether you have looked at those?

Mr. Leman: In this group, the White Paper would make the comparison even worse, against Canada.

Senator Hays: Is it difficult for you to give the committee those figures? I think they are very important figures.

Mr. Leman: This would become hypothetical, again, sir. These are actual income taxes paid; they are not based on a bunch of assumptions.

Senator Hays: You made a statement that it would be more.

Mr. Leman: It is our opinion that they would be more. We are telling you as a fact what they were. We are trying to stick to facts.

The Chairman: All you can do, I assume—I assume we could do it—would be to take the individual rates for these categories in the White Paper.

Mr. Leman: Except, sir, that you might have the trouble with the integration system under the White Paper, applying it to these cases. You do not know what integration these boys would get in Canada.

Mr. Lees: We do not know their dividends, their interests and so on.

Mr. Leman: We are basing it on their earned income here, on their salary and income only.

The Chairman: So integration would not enter into the calculations?

Mr. Leman: No. If we took the White Paper taxation only on salary, we could make the calculation.

The Chairman: That is right.

Mr. Place: We were looking at it mainly from the point of view of the difficulties that one would run into, in transferring employees back and forth between the United States and Canada.

The Chairman: I think we can figure it out ourselves if it is not convenient for you, as to how much more that would be multiplied, with the rates in the White Paper.

Mr. Place: We did in our submission here, we have tables showing this.

The Chairman: You have taken some illustrations.

Mr. Place: On pages 41 and 42. These could be interpolated in these results but they would be an afterthought. Quite frankly, where Mr. Leman suggested that perhaps it would be interesting if we picked out ten or twelve cases in one of our companies in the United States and ten or twelve corresponding cases in Canada and simply said to the individuals in effect "please tell us how much tax you paid on your income in 1969". That is what these figures show. We did not try to doctor them in any way or talk to the employees, we simply said "tell us how much you got and what you paid and what were certain expenses such as the amount of taxes you have of a municipal nature, how much mortgage you have and so on".

The Chairman: Senator Hays, Mr. Gilmour tells me we can make this calculation very quickly.

Senator Hays: It is very important.

The Chairman: We will do it. If you remember, Massey-Ferguson did carry it right through.

Senator Phillips (Rigaud): May I go back to the capital gains, in view of the fact that the briefs themselves do not form part of our hearing. At page 39 of the brief we have a more direct statement with respect to taxing capital gains on a deemed realization basis. The quotation is as follows—

> The difficulty of taxing deemed realizations are so many and the potential economic consequences so far-reaching that it should not be contemplated.

I just mention that because it seems to me that in your brief you have had different people contributing different portions and then probably the brief was co-ordinated without a bit of vetting here and there, and certain statements were made with which I for one do not quarrel and then they are followed by qualified statements in other parts of the brief.

Mr. Leman: May we amend the summary on page ii and take out the word "generally"?

Senator Phillips (Rigaud): I think the discussion we have had will clarify the situation.

May I move on to another point, Mr. Chairman?

The Chairman: Yes.

Senator Phillips (Rigaud): I think this committee would like the benefit of your thinking on a matter which we consider of great importance, and that is the taxation of small businesses. Now I know you are not a small business as such, but nevertheless you are an important company. Do you think small businesses should receive preferential treatment in terms of corporate rates, and if so, what should be the definition of a small business?

Mr. Leman: Well, sir, I would like to pass that along to John Lees. We have not dealt with this matter in our submission. I think it all depends on whether one wants to use the taxation system to give some help and incentive to small businesses or not. Personally, I would be just as satisfied if we did not use the taxation system for this purpose.

The Chairman: Well, it appears to be the only system that meets all the objections that can be raised. We have had suggestions here about capital cost allowances, but that presupposes that you have depreciable assets.

Mr. Lees: In our drafting of this brief, Mr. Chairman, we finally decided to leave this out because we felt we were getting into something that we did not have that close a feel for. But we did have a paragraph in an earlier draft which said that we felt that a company should be given a fixed amount like $250,000 or $300,000 of free write-offs. We did not care whether they were capital costs, bad debt provisions, obsolete inventory provisions or what. Between the lot of these, a company has to have something, and you are giving it a certain quantum. The point is that if the business is growing, it is worth an incentive. If it is growing it must be increasing its receivables and increasing its inventory. By giving it very generous limits up to this aggregate sum, you are giving it a tax loan of, say, $150,000 or $100,000 and then you should call it quits at that.

The Chairman: But the Small Business Loans Act does attempt to provide loans, but loans have to be repaid sometime. Now what a small businessman says is this; "the only place I can get capital to expand is out of retained earnings. My business is not attractive to the investment market." Now the easiest way of giving him retained earnings that are his forever is by giving him a low rate of tax with 21 per cent on the first $35,000 which would give him another $10,000 a year.

Mr. Lees: Well, our thinking on this was that we tried to take the White Paper seriously where it raised some objections. The lower rate of tax—and slice it any way you like—does motivate people to play games with their surplus and to play games with the existing capital gains relationship in extracting the money out and to minimize their personal income tax. Since we were not that close and we did not care to get entangled too much, we took this part of the White Paper on faith. But some people feel there is a problem here. Now by limiting the sum of money to $300,000, you have your quantum on hand. It is not forever. The man's business will grow or if it doesn't grow, it will soon be out of business. But we finally decided not to get too greatly involved in this and retreated.

The Chairman: So I take it this is just an armchair view you are expressing?

Mr. Leman: Yes, sir.

The Chairman: Are there any other questions?

Mr. Leman, as you know by this time we have been through many aspects of the White Paper, but what we are particularly interested in is the aspect of the White Paper that bears more particularly on the industries and the operations of the industries of the people who are appearing. Now, within that guideline, are there any other points that you would like to bring to the attention of the committee at this time?

Mr. Leman: No. In thanking you, I would like to make the remark that some of the members of your committee seem to be a little disappointed that Alcan did not philosophize more on the whole approach of the White Paper. Perhaps that is true, but we felt that our primary duty was to give as many facts as we could give.

The Chairman: Yes, and you have developed those in relation to the effect on yoor business, and that was perfectly proper. But having you here and knowing the experience and the spread of your Company, we thought that somewhere you might have picked up

some experience that we could extract from you.

Mr. Leman: Well, there is one general remark I would like to make which is a little bit more to the philosophical end of things. As I read the White Paper on the international income side, there seems to be a concept that international business and competition is a sort of an easy ride. It is run by big companies and therefore it is secure, safe and big, etc. Our experience proves that it is the other way around. It is a very highly competitive situation and it does not take very much of a disadvantage to make even the largest corporation begin to go down hill in relation to its competitors.

Mr. Lees: Mr. Chairman, I would like to take a moment to get into the record a statement about flow through. We are going to submit a supplemental on this, but would it be in order to put a few sentences in as to why we want to stress this particular aspect?

The Chairman: Of course.

Mr. Lees: We talked this morning about multi-national corporations and what is important to them. One of the points is that once the foreign dividend income comes in to the headquarters of the multi-national corporation, it be not taxed. Secondly, that the capital tax either in the form of a true capital tax such as we have in the provinces or a capital gains tax should be kept down to a very low cost because you are dealing with high investments here and a high capital base, and you need to be able to change your capital base. Canada historically has been very good on this. The last problem, and it is one that has got worse in Canada since 1960, is concerned with taxes on dividends. At that time the withholding rate in the United States was 5 per cent on dividends if you had a subsidiary relationship. That was withdrawn and the rate went to 15 per cent.

Now, as you look at the parent-subsidiary relationships in all the major foreign countries, they try to negotiate rates of withholding tax at zero to 5 per cent and sometimes 10 per cent, but rarely do you find 15 per cent. If you do find 15 per cent, it is usually because the corporation tax is 25 per cent or 30 per cent or at any rate very low. We think it is difficult for Canada to reduce that withholding rate on subsidiaries below 15 per cent because of the high foreign ownership in the economy and we can see that it is going to be difficult. The one genius idea in the White Paper that I think is worth carrying home is the flow-through because it permits a multinational corporation to bring foreign income into Canada and to pay it back out again to its foreign shareholders without imposing another level of withholding tax and this is worth keeping. What worries us is that when we criticize integration, there must be a pearl in this somewhere, so let us find it and keep it. This is it; we would like to put in a supplemental, and this is the pearl we find in it.

The Chairman: You are no doubt familiar with the expression that you do not want to throw the child out with the bathwater!

Are there any other questions? Is there anything further you want to add, Mr. Leman?

Mr. Leman: No, thank you, sir.

The Chairman: You may have seen this morning that we have been through a lot of situations, even on the international side, and we want to hear everything you have to say. We have gathered quite an understanding up to this moment.

Mr. Leman: This is quite evident from your comments, Mr. Chairman.

Mr. Place: The only other area in which we have some concern is that as a multi-national company we do have problems with transferring people back and forth. Also, as a large corporation we are running into a factor that more and more corporations have, which is the problem of adequately retiring our older employees. We have touched on the difficulties in connection with pensions, and the disappointment we as a corporation feel in respect of our employees that there has been no change in, for example, the amount of deductions allowed towards our recognized pension plan for $1,500, a figure that has been in the legislation for I do not know how many years, and which is obviously inadequate under present circumstances.

The Chairman: Do you have a profit sharing plan?

Mr. Place: No, we do not have a profit sharing plan as such. We have had share purchase plans at one time or another, but because of the rather spotty experience of our stock I suspect our employees have not, unfortunately, made much money. We have also had share option plans, and every time we came to Ottawa to complain about restric-

tions of those, the taxes and so on, we have been given the impression that this is solid gold, you have a share option and cannot help but make money. But you can lose it, and lose it awful darned fast, particularly under Canadian law.

The Chairman: What about the averaging proposal in the White Paper and how it might affect lump sum payments?

Mr. Place: We think the averaging proposal in the White Paper is virtually useless. It is nothing like as good as the section 36 formula that we already have. We would hate to see the section 36 formula left out.

The Chairman: Honourable senators, we will hear now from the Investment Dealers' Association of Canada. I understand Mr. Dinnick will be their spokesman.

Mr. J. S. Dinnick, President, Investment Dealers' Association of Canada: I will say a few brief words, and then Mr. Manning will speak.

The Chairman: You are familiar with the way in which we operate. In other words, you have an opening statement?

Mr. Dinnick: With your permission, Mr. Chairman, I propose to make a two-minute statement, and then Mr. Manning will make a five-minute statement.

The Chairman: You do not need to tell us the limits.

Mr. Dinnick: Mr. Chairman and honourable senators, as President of the Investment Dealers' Association of Canada, I am here today with our delegation representing approximately 140 investment dealers, and some at least of the hundreds of our approximately 750,000 small and large investors with whom we deal across Canada.

With me on the delegation are the Honourable E. C. Manning; Mr. Murray Cox of Bell Gouinlock and Co. Ltd. of Toronto; Mr. William Thomson, who is first Vice-President of the association and President of Pemberton Securities Ltd. of Vancouver; Mr. Jack Van Duzer, a director of Mills, Spence and Co. Ltd., of Toronto; and Mr. Harry Gassard, our Executive Director.

In preparing our brief, we have viewed the White Paper proposals from the standpoint of the kind of Canada its implementation will produce in the years to come, or rather our assessment of the kind of Canada this paper will produce. We feel that the proposed taxation system could easily over a period of time change the texture of our population, and not necessarily in a favourable way from our standpoint. We have tried to assess the stated objectives of the White Paper with a view to determining whether they will assist or detract in the attainment of the goal we believe most Canadians cherish.

Our association has zeroed in on four or five principal points. We have covered a number of others, but the question of continued stable economic growth we deem to be a very important attribute of any tax system. We suggest a limitation on government expenditures, and to this end have suggested that an independent study group be appointed to determine whether there is not a limit or a fixed percentage of the GNP that should be allowed to be taken from the public in taxes. In our brief it is called a royal commission, but we have deliberately changed it to "independent study group", because it sometimes takes a little less time to come through with an independent study group. Our delegation, as you can see, is drawn from widely separated parts of Canada—British Columbia, Quebec, Alberta and Ontario. Mr. John Ostiguy from Quebec is not with us this afternoon; he was with us when we appeared before the Commons committee yesterday.

In our conversations across Canada we were fortunate in discovering that the Honourable E. C. Manning, a distinguished statesman and premier of Alberta for 25 years, between 1943 and 1968, was prepared to raise his voice with ours. This gentleman, neither a Liberal nor a Conservative and with no political aspirations of which we are presently aware, is speaking with us. He needs no introduction from me. I am not going to spend a minute in introducing him, because he is too well known to you. I will now call upon Mr. Manning to introduce our brief to you.

Honourable E. C. Manning, (Thorne, Gunn, Helliwell & Christenson, Edmonton), Consultant, Investment Dealers' Association of Canada: Mr. Chairman and honourable senators, we are well aware that you have received many representations on the White Paper. A large number of them have dealt with the particular problems they would create for the organizations or corporations making the submissions. I think that is all to the good, because a large number of such

representations from every region of Canada, taken together, have certainly brought to your attention the wide cross-section of public reaction and business reaction to the proposals.

I am not here today to champion the interests of any particular group, but I was pleased to join with the Investment Dealers' Association in their submission, because the nature of their work is such that they are in contact with thousands of people throughout the length and breadth of Canada, representing people with very modest means up to the largest corporations and governments themselves. For this reason I feel that they are bringing to you in their submission a very diversified submission as to the reactions current across this country today.

Secondly, as you gentlemen know, I have spent a third of a century in public life and I can honestly say that I do not recall an official government document in all of that time that has engendered more concern throughout the length and breadth of Canada than this White Paper on tax reform.

I would like to suggest to you, and these points are covered in the association's brief, that when all the representations have been heard from the numerous interested groups, the wisdom of the Government's proposals should not be appraised on the basis of their individual academic sounds. Many of these things, which seem all right by themselves, take on an entirely different complexion when they are assessed in the light of the total package and the aggregate impact of the proposals on Canada as a whole.

I believe we can agree that Canadians today are concerned about the quality and aspects of Canadian life, that is the social as well as the economic aspects. They are concerned about human needs, human values, employment opportunities, the abolition of poverty, and the innovations necessary to meet these needs.

My first submission is that in assessing the aggregate impact of these proposals we should assess them in the light of what will be their impact on both the economic and social objectives we want to see attained in Canada in the years ahead.

The second one which stems from that idea and which I believe will be readily accepted is our capacity as a nation to obtain desirable social goals. This depends primarily on the adequate long-term development of the national economy. Stable economic growth and social betterment are inseparably related because it is the first that generates the employment opportunities, the productivity and the tax revenues that are necessary to make the second possible.

I might refer again to this great concern about unemployment we hear today. The private sector in this country must always be the major supplier of employment opportunities. I am not depreciating the role of the public sector, but primarily we have to look to the private sector for job opportunities. The extent to which those opportunities will be available in the future is very closely related to the economic health and economic expansion of the country.

My third premise is that the national tax system is one of the most potent factors affecting the economic growth of a nation. It has great potential either to stimulate or to impair economic progress and therefore the social progress as well. That leads us to the question of what effect will the White Paper proposals have on both economic development and social progress. It is my firm conviction, and this is expressed in the association's brief, that while there are some good things in the White Paper, the aggregate impact of these proposals on the Canadian economy will be negative.

Without going into detail there are at least some very obvious reasons why this will be so. They are as follows: a large increase in the aggregate tax revenue that would be extracted from Canadian business and Canadian people, sharply increased tax rates imposed on middle and higher income groups, which are an important source of domestic capital, the proposed modification of incentives presently provided to encourage resource development, and an imbalance between the tax burden borne by individuals and corporate citizens in Canada as compared to the United States; also the abolition of the present lower corporate tax rates applicable to small companies with no alternative provisions to meet their present circumstances, the disinclination to work and save and invest, resulting from the combined impact of a high tax rate on middle income groups, the taxation of capital gains, the gift tax and the estate tax when they are taken together.

Honourable senators, we suggest that it is not an adequate answer for the proponents of the White Paper to say that the adverse effects of some or even all of these factors will be minimal or at least not as great as many believe them to be.

One point I would particularly like to stress is that the effect of these proposals in the aggregate to some degree at least—we may differ—is going to be negative. Even a neutral tax system is proving inadequate to meet the present and the future needs of this country as far as economic development and growth is concerned. Surely our great requirements today, if we are going to change our tax system, is to try and change it in a way that will produce a positive stimulating impact on economic growth and development and thereby make possible social progress as well.

Our submission is that if we are going to make changes let us make those changes which will have a positive impact, and certainly not ones that will make a negative impact. I do not want to take your time other than to mention that the three obvious requirements for stable economic growth are adequate capital, skilled manpower, especially young men with managerial capabilities, and an economic social climate that stimulates incentives and inspires confidence. In our view the White Paper proposals are going to affect all of these adversely. We have indicated in the brief how these proposals tend to reduce the supply of domestic capital in both the incentive and the financial ability of the Canadian people to participate in the development of their own country. This certainly is going to lead to great dependence on foreign capital at the very time the Government of Canada is emphasizing greater national independence and self-sufficiency.

With respect to the question of skilled manpower, especially trained young people, surely our tax system should go as far as it can to offset the advantages offered, say, in the United States by more diversified opportunities and generally higher salary levels. If it cannot do that at least it should not make it more financially advantageous to find business and professional opportunities in the United States.

My closing word is on this matter of confidence and business climate. Since the White Paper was published, the concern it has engendered in this country has resulted in the deferment of hundreds of millions of dollars of industrial and commercial expansion. It is our view that it is definitely in the public interest that that concern be removed. In order to be removed it will require positive assurance on the part of the Canadian Government that proposals responsible for legitimate concern will be discarded or at least deferred until there is a far more thorough investigation into the full implications of their implementation than has been made to date. We suggest and hope that the recommendations of this important committee might be directed toward helping to attain this.

Mr. Dinnick: I neglected to mention to you that we have placed in front of you charts which are also contained in our brief. You may have already seen them. They relate our present tax system from 1949 to 1968 in so far as they relate to growth in GNP, growth in employment, growth in labour income, growth in corporate profits, capital spending as a percentage of GNP and taxation as a percentage of GNP, comparing our existing system with that of the United States and the UK. I think you will see from them that Canada's present or 20-year old tax system has produced satisfactory results.

The other thing I neglected telling you about is the study we proposed in which I said we are zeroing in on several aspects. I neglected to mention such important things as integration, capital gains, small businesses and several other things. I will add that and then cease.

The Chairman: You are ready for questions?

Mr. Dinnick: Yes.

The Chairman: I take it, in view of the suggestion that you made this morning that we do not need to spend too much time on the matter of Subpart F of the United States Internal Revenue Code. You were present when Mr. Caplin gave his explanation, were you?

Mr. Dinnick: No, I am afraid we were not.

The Chairman: Mr. Caplin and Mr. Ross were here. Mr. Caplin was in the internal revenue when the subpart F was formulated, and Mr. Ross was in the treasury. They explained the purposes behind this and the purposes had to do with overcoming the problem of balance of payments in the United States—not specifically in relation to the correction of abuses. Then he went on to tie that in to the direction in which the United States has gone since that time and a direction away from the methods of the subpart F in more positive directions of encouraging the aspect of domestic industry in the United States and the operation abroad in the export market so

as to bring home the revenues and all aimed at the matter of balance of payments. So we had an excellent dissertation from Mr. Caplin. I would commend it to your consideration in reading. But if there is anything that you want to add, now that you know the background of what we have, you may add it.

Mr. Dinnick: Unfortunately, we did not hear the statement this morning so we are a little at a loss as to where we should commence adding.

Senator Phillips (Rigaud): I would say that while you may not have had an opportunity to hear it, you may be able to deal with some of the questions we have. I would like to introduce a personal note. Many years ago when I was a young man, the late Mr. Murray, the Prime Minister of Nova Scotia, said that my future lay in Alberta. I think that I should have followed his advice and you might have had the extraordinary effect of a Liberal being one of Mr. Manning's followers.

Hon. Mr. Manning: The wise men have been coming from the east for a long time.

Senator Phillips (Rigaud): Which is not surprising. I would like to put this question to you, Mr. Manning. You did not deal with a very interesting phase of the brief which was intriguing us here, that is, the problem of the acceptability of this whole White Paper concept to the provinces. As you know, this is dealt with in the White Paper and seems to be a *sine qua non* according to the White Paper thinking, that in order really to get through with implementing legislation, the consent of the provinces is needed. With your background and everything that goes with it, do you see any likelihood of any serious acceptance of this approach, by the provinces?

Hon. Mr. Manning: I perhaps should say I purposely did not attempt to deal with that, because I have been associated with provincial government for so long until recently that I did not want to leave the impression that I was still trying to speak for provincial governments. I have to make that clear, that I am not in a position to express other than my own opinion. My assessment of the White Paper is that the proposals will prove closely inadequately to be acceptable to the provincial governments generally across this country.

The two great areas of concern that I feel the governments will have are, number one, the improvement in the fiscal position of the provinces as a result of anything in the White Paper will be minimal in relation to the rapidly rising costs in those fields for which the provinces are constitutionally responsible. I am thinking particularly of education and health in these areas, in which we have the greatest, almost uncontrollable growth, of public expenditures.

Secondly, if the estimates in the White Paper and those made up by other authorities are correct, with respect the aggregate increase in federal taxation that these proposals will lead to—and I know there is a very wide variation of opinion, ranging from $650 million up to $1,250,000—somewhere in between. If it proves to be the case that the changes in the federal taxation will take that amount of additional federal taxes out of the pockets of Canadian business and Canadian people, this is going to have a serious effect on drying up the fields of taxation which remain to the provinces or at least make it less productive.

I can recall so many occasions at federal-provincial conferences where the provinces expressed the view that the fiscal arrangements with the federal Government were not satisfactory and we got the answer that if we did not feel that this was enough we could go back and impose our own taxes. But if the federal tax level is taking so much out of the total pot it is useless to say to the provinces that they should go back and take some more because there is a limit to what the Canadian taxpayer, either corporate or individual, can pay.

On both of those premises, if I were still the head of a provincial government, I would have to say that these proposals are totally inadequate and I do not believe they would get the concurrence of the provinces.

Senator Phillips (Rigaud): We have had, Mr. Manning, some difficulty in following contradictory thoughts with respect to the movement of foreign capital into our country. Some of the representations, summarized, are that—and I think you have touched on it—because of the diversion from $1,250,000 down to $600 million into the public exchequer, obviously Canadian investments will be restricted and therefore the door is open to the acceleration for foreign capital coming into the country and aggravating the economic problem that we have.

On the other hand, from a technical standpoint, we have been told that the terms of the White Paper, if implemented, would have the effect of retarding the flow of foreign capital into the country. Has the association come to some conclusions on this point, because, after all, it is one of the organizations in the country that should be able to answer this question best. As to the White Paper, would it have the effect, assuming we had the law, would it accelerate the flow of foreign capital into Canada or would it slow it down?

Mr. Dinnick: In our opinion, we believe that it would slow it down. Would you like to elaborate on that, Mr. Cox?

Mr. Cox: I suppose this is a subject one could write a book on. We feel that in the world today there is a shortage of capital, that capital is very fluid, very mobile, and will go only to the places where it will be well treated and well rewarded. We do not think that the White Paper proposals will improve the investment climate for non-resident capital as they now stand and our concern perhaps is a double one, that if we are unable to generate as much capital internally, presumably our need for non-resident capital will be bigger and we may get a double barrelled effect that would tend to retard our economic growth.

There are so many facets of the international aspect that we not deal at length with that. We dealt more with the domestic aspect.

Senator Phillips (Rigaud): In balance, when this committee considers the subject matter—and, as you say, one could write a book on it—and probably after getting through reading it we would be facing perhaps both ways, because there are pros and cons. On balance, would you say there would be a slowing down of capital?

Mr. Cox: Yes, I think there would be, sir. On the other hand, if it were made possible through inducement to bring in the flow of capital such as higher interest rates it might flow in here, despite the less favourable climate. Here again, it would be very costly to the borrowers, not only with the exchange risk, but with the basic interest factor. It is possible that interest rates might rise enough and Canadians be prepared to pay enough to bring more or less the same amount of borrowed capital into the country.

Mr. Dinnick: I think I could sum it up in a visit I had last week, when I was discussing the references we had made to American tax law, in the hope of checking out any statements we had made and we were discussing the entry of capital and they said that we can sum it up very simply, the host countries sets the rules, we play them if we like them, if we do not like them we go elsewhere. I think our rules are not being improved in attracting foreign capital. I would say that the White Paper, if implemented, will detract from the entry of the quantity of money we need.

Senator Beaubien: On that point, I understood Mr. Lang to say that there were hundreds of millions of dollars capital investment now being deferred. I wonder if you would like to comment on that?

Hon. Mr. Manning: There have been a number of major industrial and commercial expansions which the companies responsible for said definitely that their reason for deferment is the uncertainty engendered by the White Paper. I think it would be improper for me to deal with individual companies because I have not their commission to do it but the newspapers have carried these accounts and some of them I know have made submissions to this committee and to the Commons committee. I can say this, that a very promiment Canadian industrialist told me within the last two weeks that within his personal knowledge, he knew of over $900 million of deferred commercial and industrial projects in Canada. I have not the verification of his figures, but that is what they were.

Senator Phillips (Rigaud): Leaving the figure aside for the moment, would that be deferments by Canadian companies or would it be inclusive of deferments by foreign capital coming in?

Hon. Mr. Manning: Some of these would be Canadian companies but some would be foreign companies operating in Canada. It would involve both foreign and Canadian capital.

The Chairman: But would this be the risk capital area?

Hon. Mr. Manning: Not always, no. Some of these would be well established industries who have expansion programs which have been put on the shelf until they find out what the entire picture is.

The Chairman: Would you care to discuss this in relation to the extractive industries at the moment, mining, gas and oil?

Hon. Mr. Manning: Well, in the petroleum industry, I know this has happened.

The Chairman: Are you ready for some questions in relation to incentives in the extractive industries? We do not have to argue whether they should be kept because the White Paper agrees that they should have incentives. The whole question is the quantum. The White Paper thinks that the incentives are greater than they need necessarily be. Now, looking at the mining industry and the tax holiday, in studying the financial statements of large mining companies, you will see that by the process of not writing off pre-production expenses and depreciation during the tax holiday period, effectively the mines have enjoyed it for about twice that period, and it would be about six or seven years on average before they start paying taxes. Now this might appear puzzling to the man on the street. Now we have had some suggestions not to do away with the tax holiday because that seems part of the financing format that foreign capital knows and has confidence in, but rather the suggestion has been to require in conjection with the tax holiday some percentage of write-off of preproduction expenses in that period. The balance of it, what is left, of course would be tax free. As to what that percentage should be, we have not had any firm statement yet, except the idea that some of it should be written off in that period or deducted from the total by the end of the period. Do you think that would be a reasonable limitation that in your experience would not unduly offset the appeal of this as a tax incentive?

Hon. M. Manning: I should say I am not particularly knowledgeable in mining, but those in that industry with whom I have discussed the White Paper are very strongly of the opinion that the lesser inducements proposed in the White Paper as compared with what they now enjoy is going to be seriously detrimental. Now in the petroleum industry, I know that this is the case, and where you have an industry, as Mr. Dinnick said a few minutes ago, where you have the hosts laying down the rules, then you can play or you need not play; but when you are dealing with international companies that operate on a world-wide scale, if you remove the inducements so that the place and the situation is no longer as attractive as it was or as it is somewhere else, you get a dropping-off of development. They can wait it out. The international companies in the petroleum industry are just as concerned about what their supply picture is going to be 50 or 100 years from now as they are about what it is going to be five years from now.

The Chairman: Coming back to the mining industry for the moment, did I misunderstand you? Did you say that if there was something less in the way of inducements than the White Paper offers—I understood you to say that, but I am not sure that is what I heard.

Hon. Mr. Manning: If it was something less than what it is now, or what it used to be, they do not feel that the present inducements are even adequate and if anything less were offered, it would have a serious impact.

The Chairman: Except that you have cases where within a period of eight years, a company had completely repaid all its debt on its mining operations, but if this is not your particular forte, let us move into the oil and gas industry. The White Paper suggests an earned depletion basis under which you would get a dollar for every three dollars you spent. Now that does not seem to be a principle that you could apply or that every oil and gas company could qualify for. I am thinking, for example, of the tar sands development; they have the resource there and so they could not earn depletion of the type that the White Paper talks about. Take the iron ore industry in Labrador; they have 100 years' supply, or so they tell us. They do not have to explore for it. Therefore they could not earn depletion in the way in which it is provided in the White Paper. In your opinion, would this create any problems if the formula for depletion were changed so that, if there was a percentage called depletion that you qualified for in any event, then the other elements of earned depletion could proceed on the basis of the White Paper and might be cut down? For instance, one company, a large company—I think it may have been Gulf—suggested that there might be a 20 per cent depletion as an alternative, instead of the $33\frac{1}{3}$ per cent, based on gross production income instead of on net production income; secondly, they said that the earned depletion would be available on the basis of a dollar for every two dollars spent. That obviously is a compromise and is designed to produce overall, I would say, for those who can earn both

of those, about the same amount as they get at the present time. Do you think the fact of making changes of that kind in relation to depletion would cause a loss of confidence in the international financial market?

Hon. Mr. Manning: If I may first comment on some of the points you made; within the petroleum industry itself, there are such fundamental differences in costs of exploration and development as between what is usually regarded as a conventional industry such as the development of the tar sands that the one set of rules will not apply equitably in both cases. The tar sands development is certainly a project which is right now hanging in the balance because of concern as to what these proposals may do. Again I can only reinterate what I have been told by my friends in the petroleum industry and that is that they feel that the proposed adjustments in the White Paper would certainly be less attractive to them than what they have today, and while some might favour this idea of a combination, I frankly think that you would find others who would say that it is completely unsatisfactory. In general I believe the feeling would be that they would prefer to retain roughly what they have today.

The Chairman: Yes, but supposing, as time marches on, you reach the stage where at least you must change the parts of the game, although overall you preserve the prescription, that is the tax holiday and the depletion, and there is an element of incentive even in the change—my question was not whether the petroleum industry would accept it; my question was, do you think it would sufficiently disturb the capital market or the risk capital market to the extent that you could not get financing in this area?

Hon. Mr. Manning: Taking into account the other factors confronting the petroleum industry, in my assessment it would seriously disturb it, because the petroleum industry in this country is up against very tough competition from other areas in the world where there are a lot less problems in the development of petroleum that you have in Canada, market-wise, geographically and so far as the cost factor and things of this kind are concerned, and in my assessment, at least, for a considerable time in this country while there has been a very healthy development of the petroleum industry, it has not been an area which is unduly attractive to the international petroleum industry and it would take very little for them to say "well, this is just not attractive."

The Chairman: Well, in testing just how attractive an incentive is, the Hudson Bay Gas and Oil Company, when they were here, told us that 1969 was the first year in which they took any depletion. In other words, you have to earn income in order that the depletion will work. It worked in 1969 and they paid their first dividend in 1969. Surely the international brisk capital market have knowledge of all these things. Is it a fetish, that for many years oil companies have such a program of exploration and development that they do not have enough earnings to be able to take depletion, and they cannot carry it forward; they either take it or lose it?

Hon. Mr. Manning: It may be true in some cases. I would hesitate to say it is a general condition.

Mr. Dinnick: I know this is a great opportunity, having a statesman and oil expert here, to probe him on the oil side. Nevertheless, we do have some stands on integration and a lower rate of interest on the sale of small amounts of municipal and provincial bonds, which we think could offer a very interesting compromise, particularly on the first $1,000 of income to individuals derived from their ownership of municipal or provincial bonds.

The Chairman: Well, you just go into it and develop that line. Mr. Manning and I have had our chat.

Mr. Dinnick: I know this was an interesting subject, but we are a joint group who have a great many views, and that was an important part of it.

Senator Phillips (Rigaud): Mr. Chairman, with your approval, before we zero in, which I think is the right thing to do, on some of the specific points, I should like to get one further aspect cleared up generally. Are the terms of the White Paper if implemented inflationary, in your opinion, Mr. Manning?

Hon. Mr. Manning: Yes.

Senator Phillips (Rigaud): I assume that all other colleagues of this important group feel this same way?

Mr. Dinnick: Yes. We have reasons.

Senator Phillips (Rigaud): I think it is one point that we did not cover on the broad

philosophy of the White Paper. We are ready for the zero now, Mr. Dinnick.

Senator Hays: Mr. Chairman, could I ask a question before we get on to that?

The Chairman: Yes.

Senator Hays: On page 31 of the brief you say that probably a better way of raising revenue would be by indirect tax, and you get into the field of consumption taxes, and speak also of the lower income group. How would this be of benefit to them? Probably you could enlarge a little on what area you put on this indirect tax? Is this on everything, including food?

Mr. Dinnick: I think the short reference we made attracted undue attention in the release that came out this morning regarding the hearings yesterday. I do not think it has ever been our intention that a sales tax would alleviate the necessity and change the tax structure materially. I think Mr. Cox and Mr. Mitchell, who drafted this particular section of our report, with our concurrence, believe that with the money placed in the hands of individuals, for such things as, call them luxuries—two cars instead of one, or no cars at all—at least the individual should have the option of spending his money and paying his sales tax.

We were questioned very closely on this subject yesterday by a certain member of the Commons committee, and we then gave some answers, but I do not think we emphasized that it was not an important part of our brief.

Mr. M. D. Cox, (Chief Economist, Bell Gouinlock & Co. Ltd., Toronto) Investment Dealers' Association of Canada: I think the reason for mentioning sales taxes was that the White Paper says this is another area to be dealt with in the future. We did not feel that you could set up a set of income taxes that would be viable and then superimpose over the top of that some consumption taxes. We think probably the areas should be jointly reviewed and discussed. We did think there should be exemptions for basic things such as food, shelter and so on.

Senator Hays: Yes, I noticed that.

Mr. Cox: There is the question of an alternative, if an individual's income tax is lowered by, say, $500, he then has some options; he can buy the items that attract sales tax or refrain from buying them. In other words, he can buy liquor and cigarettes, which I guess attract about the highest level of sales tax now, or he can refrain; he can decide whether to have a car, drive it and pay gasoline tax and car tax, and sales taxes on the car. This does give an option perhaps to save, and maybe save a little more, and we are distressed at some of the aspects in the White Paper that we think would be detrimental to the rate of savings. We therefore thought that some mention should be made of this. We did not at any point think this was a satisfactory alternative, but since it was mentioned in the White Paper we made some mention of it.

Senator Hays: So you really do not feel that this is a satisfactory alternative to be pursued?

Mr. Cox: No, we do not think we know enough about it.

Senator Hays: I rather agree, because it intrigued me. I think you should have a sales tax on contraceptives too, and maybe a big one.

Mr. Leman: There would be a big sale of pills!

Senator Hays: It does give the taxpayer an opportunity not to pay tax or to substitute.

Mr. Cox: That was our main reason for it.

Senator Hays: Have you changed your mind since you were at the Commons committee?

Mr. Cox: No, sir.

Senator Hays: This is one of the few briefs that has mentioned that people who are not incorporated should be treated differently, or should be treated the same as though they were incorporated. This appears on page 36 of your brief.

Mr. Dinnick: Have you a question on that?

Senator Hays: You just point out that you think there is an inequity.

Mr. Dinnick: Perhaps Mr. Mitchell would deal with that.

Senator Hays: It deals with the corporate rate tax on page 36.

Mr. Mitchell: I think the general feeling is that small business does need some assistance, and the alleviation of the dual rate of tax without anything to take its place will be

harmful to small business. We try to rationalize the position here. We felt this may also apply, not only to incorporated businesses, but unincorporated businesses, with a similar type of relief to that that we come to on the following page should also perhaps be extended to unincorporated businesses.

Senator Hays: Do you have a group of customers who are not incorporated who are not enjoying these benefits?

Mr. Mitchell: No, we were just thinking of the general principles of taxation.

The Chairman: Your reference is to non-resident shareholders.

Mr. Mitchell: I am sorry. I do not think we have any specific cases in mind where we thought it may create hardship. We were thinking of the principles of the White Paper as such.

The Chairman: If it is a partnership option, then all the partners should have the option?

Mr. Mitchell: All the partners should have the option.

The Chairman: No matter where they came from?

Mr. Mitchell: That is right. I think there are some technical reasons in the White Paper to extend it to non-residents, but I do not think they are exactly apropos.

Senator Molson: Following on in paragraph 4.16, dealing with small businesses, it is suggested here that "special capital cost allowance rates and/or special allowances in respect of increased investment in inventories and accounts receivable thereby allowing them some deferment of tax during expansion periods".

It has been suggested on one occasion in this committee that this would not achieve that purpose, but that what we need to do is define "small businesses" and then let small businesses have a lower rate of taxation. What would your views be on that?

Mr. Cox: In looking at the question of lower rates of taxation, we felt in the first place for the major corporations that the $10,000 in lower taxes was insignificant, and a source of loss of revenue to the Government, but there were probably a great many small corporations which showed no growth and no particular ambitions and were probably getting a rate of tax that was not earned on the first $35,000, but were just coasting. We did think that perhaps it involves a means test that would show a growth and a necessity for capital. We recognize their inability to raise capital and we felt that some provision should be made.

Senator Cook: To whom would they show this?

Mr. Dinnick: It would have to be a record of the past four or five years. They cannot go to a public market to raise money because they are too small. We thought there could be some deferment of tax or special allowance that would allow them to build capital in order to grow. It is a compromise.

Senator Cook: But who would say they are or are not a growth company when they applied?

The Chairman: I would not think that the investigators for income tax purposes would be any better able to say such a company is a growth company. This is only adding a further hurdle.

Senator Molson: That is what we are trying to get away from. We are hoping to find a simple formula. It has been well expressed here by a great many witnesses and it is the feeling of the committee that small business unquestionably needs incentive.

From the principle that all our large businesses began as small ones, the present system is admitted to be unsatisfactory. What do we substitute it with? One of the best suggestions we have had so far is that small businesses be given an advantage, but that that advantage not be carried through to large businesses. By defining small businesses this would be quite possible. Small businesses would be defined by perhaps the amount of net profit.

There are some companies with enormous volumes but such small margins. Their profits are negligible. This capital cost allowance has been suggested before, but it has been pointed out that in some businesses such as retail and service businesses it would not do anything for them. Do you think there would be any merit in the proposal to define "small businesses" and then attempt to find a tax incentive for them for these reasons?

Mr. Dinnick: Our basic philosophy is that we are sympathetic to the problems of small businesses because they are unable to raise money. We knew that the ball would be carried pretty capably and ably by others. We

did make several suggestions, as you pointed out, which may be impractical in application. We think there are some allowances which can be granted. I do not think they should have to pass any test, but all be defined as small businesses in order to qualify. If it is a small business it should be based on whatever dollar value it earns per annum. Under those circumstances if they do not get the benefit of a lower tax rate they should, at their option, be able to defer payment. If they have receivables at a certain amount they should be able to do certain things which they are unable to do now. We felt that others would be able to carry this more strongly than we did, but we are sympathetic to this feeling.

The Chairman: In a great percentage of the briefs this is one of the important questions which has been raised.

Mr. Dinnick: In the case of the five-year revaluation we are so certain that it is impossible and impractical that we almost left it out of our brief. But we felt we could not afford to. As I say, it is a totally unworkable system, but we must deal with it even though we now fully believe it is a dead duck.

Senator Phillips (Rigaud): You did not think it even worthy of contempt, is that it?

Mr. Dinnick: We think it is worthy of contempt, yes. But we would like to have left it out.

The Chairman: Can we zoom in, then, Mr. Dinnick, on some of the other matters?

Mr. Dinnick: We should like to state our position on integration first. I will ask Mr. Cox and Mr. Mitchell to tell you that we do not believe integration is workable.

Mr. Cox: Possibly I might make a couple of general remarks. We do not think it is workable. We think there are a lot of problems, but we did not just want to throw it out because of the estimated advantage of $200 odd million to the Canadian taxpayers. We think that under certain circumstances—for example, if Canada were a small, isolated community and there were no outside capital and no imports-exports, and so on,—it could be made to work. We hope that the tax experts in Canada can improve on the proposals and we have therefore suggested that the present arrangements be deferred and, in the meantime, that the dividend tax credit be continued or perhaps even enlarged in some instances.

Mr. Mitchell can speak much better than I can on the technical problems involved.

Mr. C. B. Mitchell (Firm of Thorne, Gunn, Helliwell and Christenson, Toronto), Consultant, Investment Dealers' Association of Canada: I am not too sure what I am going to add at this stage to what we have already put in the brief on the technical points, but I think our main objection to the integration proposals is the various anomalies the proposals will cause, and this all stemps initially from the distinction between widely-held and closely-held corporations.

You can take it from there on in and you will find any number of anomalies. We have tried to outline some of them in Appendix C to the brief. We mentioned them in rather short form, but since writing the brief we have discovered more anomalies which would result. As a consequence, we have prepared quite a bit of material on this which we would be willing to submit to this committee. It is not quite finished, but it should be within the next two or three weeks. The anomalies in this propoal are quite horrendous.

The Chairman: We would certainly like to have it by that time; sooner, if possible.

Mr. Mitchell: We shall give it to you as soon as possible.

Senator Phillips (Rigaud): Do I understand that you are to submit further material showing the anomalies that would result from the application of the integration principle? Is that it?

Mr. Mitchell: Yes. We are prepared to do so. I should qualify my statement by saying that a lot of anomalies relate to the transition from the present system to full integration and partial integration. There are a number of anomalies here for which we do not think solutions have been found; and I am not convinced solutions can be found to these particular problems. These are more technical areas rather than areas dealing with the economics of integration as such.

The Chairman: Mr. Mitchell, if, instead of using these high-sounding phrases like closely-held corporations—I cannot imagine who is holding them closely—and widely-held corporations, you were to just call them public and private companies, would you agree to that?

Mr. Mitchell: That is right.

The Chairman: In connection with the private companies it would appear that there is a problem that is apparently just sloughed over, namely, the valuation of shares of private companies. It is not the usual area for valuation that is available. Maybe there should be an alternative test there; maybe it should be book value or some established percentage of earnings—whether the earnings are, say, eight times, or ten times, whatever is the standard, and give them an option. The tendency in some cases might be to take the earnings basis and in other directions the tendency might be to take the book value. The difficulty in taking the book value, of course, is that you might run into a very substantial capital gains tax some day.

Mr. Mitchell: There are disadvantages whichever way you go. If we proceed with the White Paper proposals, goodwill will be taxable; this is one of the major elements giving concern in the valuation of closely-held corporations. If you proceed on the basis that goodwill is going to be taxable on a volume of earnings basis, which is the way the Department of Finance thinks at the present time, you have to set aside non-creditable tax in order to provide for the future tax liability of your value shares on an earnings basis. So that I am not too sure that there is a complete answer going either way. It might be an answer to give an option, as you suggest. These are things we are dealing with in detail in our study.

The Chairman: This is just talking variations and putting your finger on spots where you think there are problems. To get right down to the principle of integration, have you looked at it from the point of view of principle, as against some other method of dealing with the situation?

Mr. Mitchell: I think that because of these problems with integration, I myself concluded that dividend tax credit is the more satisfactory method.

Senator Phillips (Rigaud): On this dividend tax credit, there is an element of fraternity involved in that and I am very much interested in it because, in the old days when I was connected with the Canadian tax foundation, when we raised that issue, it was accepted by government. Up to the publication of this White Paper we were rather proud of that fraternity in the tax foundation, because we felt it worked.

Do you think that the dividend tax credit is working satisfactorily, or could it be improved by increasing or decreasing, as the case may be, the tax credit? Should it go above 20 per cent? Should it go below it? Have you studied that phase?

Mr. Mitchell: I would not like to make a positive suggestion whether it should go over the 20 per cent or not. I think we suggest in the brief that consideration be given to increasing it.

Senator Phillips (Rigaud): Yes.

Mr. Mitchell: As far as the first part of your statement is concerned, money surplus problems are going to be eliminated if you reduce the top personal tax rate as proposed in the White Paper to the 50 per cent rate. That, combined with the 20 per cent dividend tax credit, will eliminate many problems in the present act.

The Chairman: If I may interject, the White Paper says that the reason for the change from the tax credit is because so many shareholders receive dividends in respect to which no corporate tax has been paid by the paying company. Would you care to comment on that?

Mr. Mitchell: We have to agree with them, of course, on this particular point.

The Chairman: Is that an adequate reason, do you think, for scrapping this method? I am sure that must have been studied when the system was brought in.

Mr. Mitchell: Again, I deal in taxes mainly. When it comes to a theoretical point of view, I would have to say that you should probably relate the two. I think that, as a practical matter, I cannot be concerned about giving the 20 per cent dividend tax credit where there is no sufficient corporate tax paid to match the 20 per cent.

The Chairman: It is not unusual. You find in many cases in the income tax right now, where there are companies that do not have to pay any tax and I am sure you could operate with exclusions, could you not?

Mr. Mitchell: From the 20 per cent?

The Chairman: Yes?

Mr. Dinnick: In other words, base the exclusions on the tax credit, where it was not earned.

The Chairman: Yes.

Mr. Mitchell: I have not thought too much, Mr. Chairman, how you could apply those exclusions. It is an interesting thought.

The Chairman: It is not an unusual thing.

Senator Benidickson: There is exclusion for integration—for exclusions that have to be paid out within 2½ years. Those are some forms of exclusions.

The Chairman: There is inherent there now an exclusion, so if you had this one it makes the objection which the White Paper puts forward as supporting this departure from the tax credit.

Senator Molson: You mean, the tax to the extent of 20 per cent?

The Chairman: No. The tax credit, which is now 20 per cent. If you exclude it from that area, dividends from companies that do not pay tax.

Senator Molson: Any tax or tax equivalent, or what, Mr. Chairman?

The Chairman: Any corporate tax.

Mr. Mitchell: I do not know if you could define this precisely enough to make it possible. There are not too many companies which do not pay any tax and which are able to pass the 20 per cent dividend tax credit onto their shareholders. You may have companies during the three-year exempt period. However, I submit that probably very few mining companies are paying dividends in that period, unless they are well-established mining companies and are putting a second mine into production.

The Chairman: I am sure that would not be a difficult problem to deal with.

Mr. Dinnick: There are some pipeline companies who pay dividends and do not pay taxes.

Mr. Mitchell: I would like to give it some further thought, Mr. Chairman. I think it would be pretty difficult to define the exclusions.

The Chairman: You think it would be or it will be?

Mr. Mitchell: It would be. I do not know how you define precisely the type of companies whose dividends would not be entitled to the dividend tax credit.

The Chairman: I wish you would have a look at it. We are searching for all the alternatives.

Mr. Mitchell: We are doing some detailed studies in this area at the moment.

Senator Phillips: I would say, Mr. Chairman, historically, poor Mr. Carter is not here now, but I mentioned previously that he succeeded me as the President of the Canadian Tax Foundation, and deserved a good bit of the credit, with his colleagues in pressing this tax credit. The feeling then was that if a corporation declares a dividend, in law it must be a dividend that goes to the reduction of surplus and, as such, should be entitled to the dividend tax credit, because in law the corporation could not distribute that which was not available for distribution. It was not a return of capital. By its very nature it would have to be a dividend-reducing surplus. For that reason, it was entitled to a dividend tax credit.

Mr. Mitchell: I would have to agree with that. It is difficult to withhold it from some companies.

Senator Phillips (Rigaud): It does not mean to say that you should not follow our Chairman's thinking, because if we were to shoot down integration—and a lot of us have rifles...

The Chairman: At the ready!

Senator Phillips (Rigaud): ...around here, one might want to consider some alternative with respect to the treatment of tax credit.

Mr. Mitchell: As an alternative to dividend tax credit, do you mean?

Senator Phillips (Rigaud): Yes.

Mr. Mitchell: I have not given that too much consideration.

Mr. Dinnick: I think I could say that we are prepared to work with you and elaborate on any points, such as you have mentioned of integration and also dividend tax credit.

The Chairman: This includes, I take it, the 2½-year limitation on the enjoyment of creditable tax. Your view for or against that provision?

Mr. Mitchell: I think that the 2½-year rule...

The Chairman: You think that it should be shot down?

Mr. Mitchell: I cannot see the purpose of it. I do not fully appreciate the purpose of it.

The Chairman: Oh, I thought the purpose of it simply was this, to get tax revenue more quickly.

Mr. Mitchell: I am not too sure it is going to produce tax revenue that much more quickly, when you look at the personal rates schedule. When you reach the top personal rate, which is 50 per cent, at the $24,000 level, I am not convinced that forcing dividends out in 2½ years when you consider full credit is going to pass with closely-held corporations, private companies, and that 50 per cent is going to pass with the wider-held, I do not know that there is going to be that much deferment of tax.

The Chairman: What is the purpose and value of a limitation that limits the credit to the shareholder to a company which has paid taxes but then says it is limited in time to 2½ years? If the pay out does not occur within that time, the right to the creditable tax disappears.

Mr. Mitchell: The only rational answer is that the Government does not want tax deferment, but I am not convinced that much tax deferment is possible even if there were no 2½-year rule. So when you say that is not the purpose of it—and I am convinced it is not—I am not too sure what the purpose of the 2½-year rule is.

The Chairman: Is there anything else we zero in on?

Mr. Dinnick: We did make one suggestion. We think the emphasis under the White Paper full implementation would be to equities rather than to debt. The municipalities and provinces have a very difficult time. Coming to market corporations, they can gimmick up their securities with warrants or convertibility for 5-year extensible, but, of course, that option is also open to the people of whom you speak, but we do think the municipalities and the provinces have and will continue to have great trouble in getting their financial requirements met in the open, bond markets, so we have put a suggestion in there that the first $1,000-worth of income be taxed at the lower rate, say 10 per cent—whether it is 10 or somewhat higher, but 10 per cent is our suggestion.

Senator Beaubien: Does it not matter what your other income might be?

Mr. Dinnick: No, it would be the first $1,000, and this would bring in all the small investors. We think we deal with 750,000 people in Canada. We polled our membership as we prepared this brief. On the assumption that only one-third of those people exercise their option to buy one-third of the amount of bonds that they would be entitled to purchase to get up to $1,000 income, we say they should have somewhere between $10,000 and $15,000-worth of bonds at current rates. We think rates would go down somewhat for municipalities on this basis. So, on the basis of one-third of the people buying one-third of the amount of bonds which they were entitled to buy, that would be a $1 billion market, and municipalities in Canada, we feel, with the provinces, would love to have a $1 billion retail market opened up which just is not there in these days.

Senator Hays: What would be the loss to the federal treasury?

Mr. Dinnick: If it was all at the 50 per cent level, there would be $400—so if it was all bought by rich people, they would lose $400 of the $500 they collect on the first $1,000 worth of income. I think it would be quite an exercise to produce estimates. We could find out what it would be if the whole $1 billion was sold and if it was sold at, say, 8 per cent, the current rate, it would be $80 million. And if it was all owned by people in the 50 per cent tax bracket, which it would not be, then those people would be paying $40 million in taxes, and we are going to assume that they are only going to pay $10 million so it is a $30 million loss per annum to the Government. Maybe I have done my arithmetic a little too quickly, but it sounds like that. I do not think it is quite that big. You see, I am assuming in the first place that everybody who bought those bonds is in the 50 per cent tax bracket, and that certainly would not be the case.

The Chairman: Even at the present rates, the 50 per cent bracket starts at the first $25,000, and that is the area where you have the savings and the purchasing power.

Mr. Dinnick: Well, then, why am I wrong? I have not worked it out before.

Senator Hays: Mr. Gilmour probably has the figure on the top of his head.

Mr. Gilmour: There are roughly more than 48,000 persons ranging from $25,000 up, and there were 37,000 of them in 1967 between $25,000 and $50,000. When you get up into the $200,000 class where all senators are, the number is 140.

Mr. Dinnick: Well, then I think you could say somewhere between 10 and 25 million for the opening up of the billion dollar market for provincial and municipal bonds.

Senator Phillips (Rigaud): I, for one, Mr. Chairman, think that this is a very important suggestion. Now I want to be sure that we have this right. Your suggestion is that in the purchase of municipals and provincials, the first thousand dollars-worth of income in respect of those securities be taxed at a flat rate of 10 per cent.

Mr. Dinnick: Right.

Senator Beaubien: It could be a withholding tax.

Mr. Dinnick: You would have to be a foreigner to have the withholding tax come in.

Senator Phillips (Rigaud): Leaving aside for the moment the complication of non-residents, your idea is that at that rate we would facilitate provincial and municipal financing, and God knows at the moment they are having their problems.

Mr. Dinnick: We just mentioned it to our sales force and they said "Every one of our clients would be in there for the $10,000 or $15,000 they are entitled to."

The Chairman: You know, the idea is not so strange. In the United States you have state bond issues that are tax exempt.

Mr. Dinnick: It is not such a benefit to the rich man because the municipality's borrowing costs will go down. People will say that these are quite good so instead of there being 9 or 10 or whatever the new rate is going to be—let us say that instead of 8—they might be able to borrow at 6 because of the attraction of this lower rate of tax.

Senator Hays: The provinces might spend more money too.

Mr. Dinnick: The provinces do not really have quite the problem of the municipalities. The municipalities do not have a market that they can go to except Toronto or Ottawa.

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The Chairman: This was not Senator Hays' comment. He was saying that if they got the money, they might be inclined to spend more.

Mr. Cox: He should bear in mind that these would not be people in the $25,000 area buying all of them because there are not that many taxpayers. You would get a lot of people in the $10,000 to $15,000 range who will be buying one or two bonds or something of that nature.

The Chairman: That is right, and they would not be buying in the range of $15,000 per person.

Mr. Dinnick: We think about a quarter of that or a third would be the average.

Senator Molson: It might be competition for the Canada Savings Bonds.

The Chairman: What is the next item we zero in on?

Senator Phillips (Rigaud): Capital gains.

Mr. Dinnick: We feel about capital gains that the graduated rate of income tax is not applicable.

The Chairman: You think it should be a special rate?

Mr. Dinnick: Somewhere between 35 and 50. But we don't think it should be there at all.

Mr. Cox: Mr. Chairman, we think that a country at Canada's stage of development possibly should not have a capital gains tax at all but in view of court decisions and the general traditions of the law, it means we will be moving into an income area. There probably are some equity aspects to taxing capital gains, and we have some thoughts on the matter.

We are a little disturbed by paragraph 2.43 of the White Paper which suggests this tax should produce hundreds of millions of dollars. We therefore felt we ought to erect a few guidelines.

We think there should be a distinction between short and long term gains. Since long term gains probably involve some aspect of inflation, presuming inflation continues, we think the maximum rate should be 25 per cent on long term gains, and that short term gains should be taxed at whatever rate they bring the person into.

We think the tax should be on realized gains only. In other words, there should be no five-year revaluation, but realization would include gifting and death, and here we suggest the removal of death and gift taxes. We think that perhaps there ought to be an option given on the original valuation of assets, and we suggest costs as well as a V-day valuation.

Mr. Dinnick: Did we set a date line on that?

Mr. Cox: We suggested five years as being a reasonable period, but there is nothing sacred about five years.

Senator Phillips (Rigaud): There are some of us who believe that the introduction of a capital gains tax, if it is to be introduced at all, should be done in gradual stages because of the obvious difficulties of dealing with the subject matter of valuations and all that sort of thing, and the desirability of examining homes, and farms, and the roll-over provisions, and the problem of people living in the country which was referred to by the Alcan gentlemen, and the like. What would you think of the introduction of a flat capital gains tax applicable only for the present on listed stocks, until the public became accustomed to this business of paying capital gains tax? So, we would have a simple rule of costing and a simple rule of realization, and a flat rate applicable thereon, in order to get the people accustomed to this sort of thing. At the same time, from the point of view of world capital and world opinion, we would not bring our country into line with the United States which, after all, does not require foreign capital to the same extent that we do. Would your industry feel that we are singling out the companies with which you deal, and which in fact you sponsor, more than any others if we suggested such a simple application of the capital gains tax?

Mr. Van Duzer: Mr. Chairman, would you not, if you adopted this approach to a capital gains tax on listed stocks only, drive money into other areas for speculation?

Mr. Dinnick: Into real restate, possibly?

Mr. Van Duzer: You could name any area.

Senator Phillips (Rigaud): I know that. That is why I am putting the question. There are obvious disadvantages, because a great bit of it would go into land; some may go into paintings; some might go into objets vertu or objets d'art; there are all sorts of place where it might go. On balance in relation to a young country needing capital, would it not be a simple way of dealing with the problem at this stage?

Mr. J. F. Van Duzer, (Director, Mills, Spence and Co. Ltd.), Investment Dealers' Association of Canada: This is discrimination.

Senator Phillips (Rigaud): Or would the amount of damage done by this approach offset the advantage?

Mr. Thomson: I should like to comment that one reason why we are suggesting a lower rate of short term capital gain is because there are so many speculative gains on the short term. We think they are legitimate for a capital gains tax. So many of these are in the area of unlisted mining stocks, even new ones, that it would be very difficult to keep a list up to date in the tax department. Somebody would be going round forming a new company maybe to avoid listing, but to get the benefit of a quick capital gain without having the levy to contend with.

Mr. Dinnick: I personnally think it would be impractical to suggest that it start with purely listed stocks, because the other avenues are just as attractive and lucrative, and it would be discrimination. We have lived with a capital gains tax in our business, because we could not as a corporation buy anything and make a capital gain.

Senator Phillips (Rigaud): You have lived with inventory, not capital gain.

Mr. Dinnick: We have lived with inventory for years. We know what it is all about. Perhaps that is why we do not think it should happen, but we are resigned to it.

The Chairman: Going back to the question of what the White Paper says about the amount of money that will be realized in capital gain, I note that in the \$35,000 to \$50,000 range of taxable income, on the 1967 figures there were 39,689 persons; in the range from \$50,000 to \$100,000 taxable income there were 7,243; in the range from \$100,000 to \$200,000, there were 1,005. Does anybody want to put a hand up and say he was one of those? In the \$200,00 and over category there were 140 persons. If we rule out people under \$25,000 as persons who might speculate and make capital gains, in that area of taxable income there are 48,000 people, individuals, to produce some part or all of that hundreds of

millions of dollars of capital gains. Does that seem like a practical or realistic approach to what the revenue might be?

Mr. Cox: No, sir, it does not, but I suppose people with less than $25,000 might be fortunate enough to make a capital gain.

The Chairman: Yes, but it would be an extraordinary kind of capital gain with the amount of money they would have left; they would have to multiply it many times over. That is some person I would like to sit beside.

Mr. Cox: I must say I looked twice at that in the White Paper. If I may speak to Senator Phillips' suggestion, I would say that we had an idea that perhaps roll-overs might be more generous than are provided in the White Paper, particularly as regards housing. Roll-overs for capital losses should be included. We think a different idea or concept of the averaging income would be necessary. We have been toying with a block averaging concept, because we think it is important to provide for people whose income declines. The whole emphasis of the White Paper proposals seems to be to provide a minimum amount of relief for people whose incomes tend to rise. I do not know whether Mr. Mitchell wants to speak any further on the stock averaging concept. We have given a lot of thought to it, without producing anything.

Senator Phillips (Rigaud): Perhaps the chairman will allow me to go back to the attack, because you deal so closely with securities. Suppose capital gains were confined to the purchase and sale of all kinds of securities, including land, and we get away from what I call junk categories.

Mr. Cox: Including land, not housing?

Senator Phillips (Rigaud): Not housing. Land to include investment apartments and all that sort of thing: real estate. Securities and real estate. There may also be the odd person who gets away with the purchase of a picture or purchasing an heirloom—and so what? Suppose it was so confined, instead of a complicated capital gains system.

Mr. Dinnick: I would think that if it were carefully enough defined it would be a logical approach to take in the expectation that it ought to receive serious consideration. You have covered most of the avenues of conventional investment and left out what in the past were not normally considered to be purchases to create gains.

Normally people do not buy paintings for their own house or rings for their wife's fingers to make a capital gain. You have a case to exempt them, but there obviously will be abuses.

Senator Phillips (Rigaud): Assume a flat rate of 25 per cent. How many people are going to bother to mess about buying in categories not subject to capital gains tax and eliminate the use of that money speculative-wise in respect of which they should be glad to pay a 25 per cent tax?

After all, if a person makes $1 and can keep 75 cents, he would rather speculate and buy securities, if he has faith in buying Canada long, as the saying goes, than mess around buying a picture or a diamond so as not to pay tax.

Mr. Dinnick: It would not interfere with the purchase of listed securities for one second if a capital gains tax were implemented. It would be your only avenue of investment anyway. You would have to live with whatever the new ground rules were.

People frequently say would it dry up the market? I do not think, provided it was levelled across the bonds and stocks, that it would dry up one dollar of investment.

Senator Phillips (Rigaud): That is why I am putting the question to an organization such as yours.

If we said we will tax all capital gains resulting from the purchase and sale of all types of listed securities, inclusive of all real estate transactions, period, would you feel that there would be discrimination against your industry in the investment climate and all that sort of thing if the odd person did buy a capital asset which was not subject to taxation?

Mr. Cox: As a personal judgment, your rationale is very reasonable. I do not know that any of us here would want to speak for the entire investment industry.

Senator Phillips (Rigaud): No, but we are receiving a quick reaction.

Mr. Cox: It sounds fine.

Senator Phillips (Rigaud): You do not react violently against that thought?

Senator Hays: You first said you would not approve of capital gains. Why would you approve of it at all?

The Chairman: This is the legal alternative.

Senator Hays: I do not think you should have any alternative. What did capiptal gains produce in the last year?

Senator Phillips (Rigaud): Senator Hays, you know we are now going to include herds as a result of your comment.

The Chairman: Does that cover the field that you wished to deal with?

Mr. Dinnick: I think so, sir. Our brief is there and we will be pleased to provide any further elaboration you call for.

Mr. Thompson: There is one point that I have not seen much attention paid to but which I think would be a good one to consider in view of the White Paper on Tax Reform. That is the setting up of some kind of tax review board, where you could obtain an interpretation before pursuing a course of action.

The Chairman: We have had that point raised previously.

Senator Beaubien: It is an excellent suggestion.

Senator Molson: It is a very good suggestion.

The Chairman: We are giving it consideration.

Mr. Dinnick: As a group we thoroughly appreciate the hearing that you honourable senators have given us. We do feel that we are in front of an audience which is sympathetic to the aims we have, which are to allow the virtues of hard work and the accumulation of some money and ability to improve the standard of living of a family for the next generation. And that is not a dirty thing to have happen. We still stand for the last of the practical free practising economists. Just like the grocer, we buy bonds instead of potatoes, apples and oranges, and we put them on our shelves, price them and sell them and if we are wrong we take a loss. We feel that we should still be allowed to work long hours and make a living, take some chances with our capital and reap a reward, and that it not be all taken away. We hope you agree with these views. Our industry stands for this and always has.

The committee adjourned.

APPENDIX "A"

STATEMENT OF NATIONAL FOREIGN TRADE COUNCIL

BEFORE

THE STANDING SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

STUDYING

PROPOSALS FOR TAX REFORM

April 10, 1970

NATIONAL FOREIGN TRADE COUNCIL, INC.
10 Rockefeller Plaza, New York, New York 10020

Summary

The comments of the National Foreign Trade Council with respect to the Proposals for Tax Reform embodied in the White Paper are limited to those provisions which, if enacted, would have serious repercussions on the U.S. investor. The Council will not comment upon those proposals of the White Paper which would only affect Canadians. Specifically, the proposals which are of great concern to the Council are those dealing with the taxation of unrealized appreciation, both with respect to shares of widely held corporations and with respect to all assets upon termination of Canadian residence; treaty withholding rates; stock dividends; thin capitalization; branch profits and nonresident-owned corporations.

Sharing a common language and heritage with the United States, and possessing political, social and economic stability, Canada has historically been viewed by the U.S. investor as an attractive country for the investment of capital. While encouraged by the White Paper statements that Canada remains interested in attracting overseas capital, the Council points out that competing investment opportunities at home and abroad far exceed the supply of U.S. capital available to make such investments. Analysis of the White Paper in the light of U.S. tax principles governing the U.S. investor, leads the Council to the conclusion that enactment of the proposals set forth above would create serious problems of double taxation for the U.S. investor and to this extent could seriously affect decisions on the part of the U.S. investor to make, maintain or increase Canadian investment.

Under longstanding principles of U.S. law, U.S. citizens and corporations are taxed on worldwide income, i.e., all income is included and all

deductions are allowed in determining net income subject to tax. Rather than exempting foreign source income, the U.S. has provided a credit for foreign income taxes imposed on such income actually realized. This has worked in the past to prevent confiscatory double taxation. The U.S. foreign tax credit relief is not predicated upon recognition of unrealized income. Enactment of the specified White Paper proposals could thwart the U.S. measures designed to provide relief from international double taxation, thereby increasing the overall tax cost of Canadian investment.

Taxation of Deemed Realized Gains in Widely Held Stock would discriminate against those U.S. investors who have in good faith complied with the degree of Canadian ownership program. Taxation of unrealized appreciation in stock of widely held corporations would treat U.S. investors in the same industry, and otherwise similarly situated with respect to their Canadian investments, differently. The recurring 5 year tax on unrealized appreciation might result in forced sales in order to generate sufficient income with which to pay the tax where there is little or no market for the stock sold. This would result in great hardship to the U.S. investor and would dilute its equity position beyond that contemplated when the investment was made. Moreover, even if such a tax would be considered a creditable foreign tax under U.S. law, a tax on unrealized appreciation would likely raise the overall tax burden borne by the U.S. investor with respect to its investment in a widely held Canadian corporation.

Taxation of Deemed Realized Gains on Termination of Canadian Residence would also result in a loss or dilution of the U.S. foreign tax credit relief from international double taxation, creating great hardship and immense valuation

problems for a U.S. citizen upon termination of Canadian residence. Enactment of such a provision would result in a curtailment of U.S. and Canadian technical personnel taking temporary assignment in the other country.

Treaty Withholding Rates proposed in the White Paper exceed generally accepted international norms. Accordingly, adoption of such withholding rates would place a severe burden on the U.S. investor by increasing the total tax cost of a given investment to the point where such investment could cease to remain competitive with other available investment opportunities.

Withholding on Stock Dividends distributed to nonresidents could impose an additional burden on Canadian investment similar to that resulting from taxing unrealized appreciation and should be eliminated. Elimination of such withholding would encourage the dedication of earnings to capital stock account and would tend to improve Canada's balance of payments.

Thin Capitalization proposals would restrict the deductibility of non-arm's length interest whenever the ratio of debt to stock of the debtor company exceeded 3 to 1. Since apparently only applicable to the nonresident investor, this proposal would violate the antidiscriminatory provisions of the U.S.-Canada income tax treaty. Moreover, the adoption of such a mechanical test is unduly restrictive and not in accord with international practice and would increase the U.S. investor's overall tax burden on its Canadian investment.

Branch Profits should be subject to reduced treaty withholding tax rates similar to that applicable to dividends.

Nonresident Owned Corporations paying interest and dividends to treaty country residents should continue to be subject to treaty withholding rates.

THE HOUSE OF COMMONS

STANDING COMMITTEE ON

FINANCE, TRADE AND ECONOMIC AFFAIRS

STUDYING

PROPOSALS FOR TAX REFORM

STATEMENT OF

NATIONAL FOREIGN TRADE COUNCIL, INC., NEW YORK

The National Foreign Trade Council appreciates the opportunity which has been afforded to submit its comments on the recommendations contained in the Proposals for Tax Reform (hereinafter referred to as the "White Paper").

The Council is a private, non-profit organization composed of over 600 United States companies engaged in all aspects of foreign commerce. Organized in 1914 to promote and protect American foreign trade and investment, the Council comprises in its membership manufacturers, merchants, exporters, and importers; rail, sea, and air transportation interests; bankers, insurance underwriters and others interested in the promotion and expansion of the United State's foreign trade and investment.

Since it would be inappropriate for the Council to comment on those proposals for changes in the Canadian tax system which would affect only Canadians, the Council will therefore limit its remarks to the effect which the White Paper proposals are likely to have on U.S. investment in Canada.

While apparently favoring consumption over investment and capital formation, the White Paper recognizes Canada's continuing need for substantial amounts of capital for the foreseeable future. Moreover, the White Paper states that its proposals will not cause any substantial reduction of foreign investment within Canada.

Sharing a common language and heritage with the United States, and possessing political, social and economic stability, Canada has historically been viewed by the U.S. investor as an attractive country for the investment of capital. However, the White Paper has given the U.S. investor pause to reflect upon the future receptivity of Canada as a host nation for foreign investment. Contrary to the conclusion of its draftsmen, the Council believes that enactment of the White Paper proposals could seriously affect decisions on the part of the U.S. investor to make, maintain and/or increase Canadian investment. Moreover, if by enactment of the White Paper proposals, hereinafter discussed, Canada were to impose substantial barriers to the flows of U.S. private capital, it would seem logical for the United States Government to review its policies which except Canada from its otherwise stringent rules restricting U.S. foreign investment.

As this Committee knows, there is a critical scarcity of capital in the world today. Competing investment opportunities at home and abroad far exceed the supply of capital available to make such investments. Under these conditions, management decisions of a typical U.S. investor to invest

at home or in one of several competing capital importing countries must be predicated upon an analysis of a variety of factors, one of which is the combined U.S. and foreign income tax effects of a given investment. In this regard, considerations of international double taxation, where a national of one country receives income from abroad which is subject to tax both in the country of nationality and in the other country, are of prime importance. It is therefore appropriate to discuss the White Paper within the context of the problems of international double taxation faced by the U.S. investor.

U.S. Taxation of Foreign Income in General

The U.S. asserts jurisdiction to tax the worldwide income of its citizens and corporations. Such jurisdiction is based upon U.S. citizenship or incorporation and not upon residence. Correspondingly, for over fifty years, the U.S. has permitted its citizens and corporations having fiscal responsibilities to two national jurisdictions to credit under section 901 of the Internal Revenue Code of 1954, as amended (hereinafter referred to as the "Code") against the U.S. tax otherwise payable any direct income taxes paid to the other tax jurisdiction. Under section 902 of the Code, a domestic corporation upon receipt of a dividend from a 10 percent or more owned foreign corporation is deemed to have paid and thus have available as a credit a portion of the foreign taxes paid or deemed to have been paid by the foreign subsidiary to any foreign country or U.S. possession on or with respect to the accumulated profits out of which such dividends were paid.

While the foreign tax credit mechanism presents a practical solution to the problems of international double taxation, it should be stressed that full relief therefrom is not always attainable. Recognizing that the U.S. and foreign concepts of the definition, timing and realization of income may differ, the U.S. requires that its taxpayers, in computing the allowable foreign tax credit, measure their taxable foreign income by the application of U.S. concepts even though such concepts may not be fully recognized by the foreign country in imposing its income taxes. Further, no discussion of the problems of international double taxation faced by the U.S. investor would be complete without mention of the statutory limitation on the foreign tax credit imposed on the investor by section 904 of the Code.

Section 904 of the Code provides for a limitation on the foreign tax credit which prevents any foreign tax paid to another country from being credited against the U.S. tax payable on U.S. income.* Thus, the amount of foreign tax credit is limited by the amount obtained by multiplying the U.S. tax before credit by a fraction, the numerator of which is taxable income from all foreign sources (or from sources within a particular foreign country if the per country limitation is elected) and the demominator of which is total taxable income. In effect, foreign source income (determined under U.S. concepts) is taxed at the greater of the U.S. or effective foreign tax rate. It is readily apparent, that under this formula the amount of foreign taxes actually paid and otherwise allowable for credit

* The U.S. permits its nationals to elect the computation of the foreign tax credit on the basis of either the per country limitation or the overall limitation. The per country limitation imposed by section 904(a)(1) restricts the amount of credit allowable against the U.S. income tax for taxes paid to any single country to the amount of tax imposed by the U.S. on the income derived from that individual country. On the other hand, the overall limitation provided under section 904(a)(2) restricts the amount of credit to the United States income tax on total foreign source income, treating the taxes and income collectively (rather than separately for each country).

may be reduced or eliminated where the underlying foreign source income is not considered realized for U.S. purposes.

Moreover, it should be pointed out that foreign tax credits may be lost even though both the U.S. and the foreign country tax the same income at the same statutory rate. The section 904 limitation is phrased in terms of taxable income from foreign sources either on the per country or overall basis. This requires the allocation to foreign source gross income of expenses directly related thereto as well as a ratable portion of indirect expenses such as home office and general and administrative expenses incurred in the U.S. Such allocation reduces the amount of foreign taxable income thereby reducing the amount of U.S. tax against which credit can be taken and in effect creates a higher effective rate of foreign tax than the statutory rate actually imposed. Thus, foreign taxes actually paid and otherwise creditable may be lost with a resultant increase in the overall tax cost of earning such income on that particular investment.

The United States has embarked upon an extensive income tax treaty program. The United States developed country income tax treaties generally provide for reciprocal exemptions from withholding on interest, royalties and capital gains and a reduced 5 percent withholding rate on certain intercorporate dividends which are not effectively connected with a permanent establishment of the investor in the other contracting state. These provisions lower the foreign tax to a level which can be absorbed by the U.S. foreign tax credit thereby lowering the overall tax burden on foreign investment and are wholeheartedly supported by the U.S. investor.

White Paper Proposals
Affecting the U.S. Investor

Deemed Realization of Gains in Widely Held Stock

The White Paper proposes that unrealized appreciation accruing on shares of widely held Canadian corporations will be deemed to be realized and subject to tax every five years. The tax would apply to non-residents owning a substantial interest in a widely held Canadian corporation, defined as the ownership of 25 percent or more of the shares in such corporation. However, the tax will not apply to Canadian shareholders in such corporation who are widely held Canadian corporations.

From the standpoint of the U.S. investor, the tax on the deemed realization of otherwise unrealized gain on a substantial interest in shares of widely held Canadian corporations constitutes one of the most detrimental and discriminatory proposals of the White Paper.

Foreign Tax Credit. At the outset, the basic question arises as to whether a tax on income deemed to be, but not actually realized, would be considered a creditable tax for U.S. foreign tax credit purposes. However, as pointed out below, even if such tax could be considered a creditable tax, those U.S. investors subject thereto would still encounter severe economic hardships.

As stated, the foreign tax credit available to a U.S. investor must be computed under U.S. principles which are predicated upon the theory of taxing only income actually realized (or constructively received in the case of certain controlled foreign corporations). Mere unrealized appreciation in value of stock will not result in the realization of taxable income for U.S. purposes. Thus, a U.S. taxpayer subject to Canadian tax with respect to deemed realized capital gain (i.e. unrealized capital appreciation) on shares in widely held Canadian corporations would have no income from this source against which a foreign tax could be utilized.

Assume the following facts: A U.S. investor pays a $50 Canadian tax with respect to $100 of unrealized appreciation on shares of a widely held Canadian corporation and realizes no other foreign source income but does realize $100 of U.S. income which bears a $50 U.S. tax. Under U.S. tax principles, the U.S. investor would have no taxable income from foreign sources. Therefore, the section 904 computation, foreign source taxable income over total taxable income multiplied by the $50 U.S. tax produces a result of zero (0/$100 x $50=0) and accordingly, would preclude the utilization of any of the $50 Canadian tax as a credit against U.S. tax. At the same time, the U.S. investor's basis in his Canadian shares for U.S. purposes would not be increased by the periodically recurring Canadian tax.

While such excess foreign tax credits (assuming that a tax on unrealized appreciation could be creditable against U.S. tax) might be available

on a carryover basis for a limited period when such stock is actually sold at some future date within the carryover period, such sale might never occur or the value might decline sufficiently so that a loss would be suffered on such sale. In such case, no U.S. tax relief could be secured for the Canadian tax paid on the prior unrealized appreciation. Although U.S. direct investment is generally made on a permanent basis, the recurring 5 year tax on unrealized appreciation might result in forced sales in order to generate sufficient income with which to pay the tax where there is little or no market for the stock sold. This would result in great hardship to the U.S. investor and would dilute its equity position beyond that contemplated when the investment was made.

Losses. The treatment of losses with respect to the tax on unrealized capital appreciation is particularly vexatious. First, although a U.S. investor's cost basis in widely held stock may be greater than its value on valuation day, the later will prevail. In effect an unrealized loss will be taken into account for valuation purposes to the investor's detriment since there will be no offsetting tax benefit while, should the value subsequently increase, this "fictitious" unrealized capital appreciation would be subject to tax. Such a result would almost always be obtained if the investment were relatively new and in the formative stages. Similarly, there would appear to be no relief in the case of future fluctuations in the value of a stock at each five year interval. Second, the White Paper does not indicate whether a U.S. investor could net unrealized gains and losses in widely held Canadian corporations in which it holds substantial interests. If he could not net his gains and losses there does not appear to be any way in which such losses could be effectively used by a nonresident.

Treaty Considerations. Article VIII of the existing U.S.-Canada income tax treaty provides that:

> "Gains derived in one of the contracting States from the sale or exchange of capital assets by a resident or a corporation or other entity of the other contracting State shall be exempt from taxation in the former State, provided such resident or corporation or other entity has no permanent establishment in the former State."

Inasmuch as Article VIII only proports to deal with gains derived from the sale or exchange of a capital asset, a question arises whether Article VIII would offer immediate protection to the U.S. investor subject to the proposed tax on unrealized appreciation in the shares of a widely held corporation.

The Council assumes that Article VIII as presently constituted will apply and afford the U.S. investor an exemption from the tax on unrealized appreciation in shares of widely held corporations. This is in accord with simple fairness since it would be unreasonable to tax unrealized capital appreciation where an actual sale or exchange of the underlying stock in a widely held corporation would be exempt from tax pursuant to Article VIII. Moreover, the Council must point out that due to the severe hardships that would result to the U.S. investor, it would be forced to strongly oppose a subsequent change in Article VIII to remove this protection from any tax on unrealized capital appreciation.

Discrimination. Application of the tax on unrealized capital appreciation in shares of widely held corporations to nonresidents results in a double discrimination insofar as the U.S. investor is concerned. First, the recurring 5 year tax on unrealized capital appreciation with respect to a

substantial interest in a widely held Canadian corporation does not apply to Canadian shareholders in such corporation who are widely held Canadian corporations. On the other hand, the tax clearly would apply to the U.S. corporate investor who is a shareholder in the same corporation. Unless the contemplated income tax treaties which Canada will enter into after enactment of the White Paper proposals provide to the contrary, this would seem to be a clear violation of the typical antidiscrimination treaty clause adopted in the developed country income tax treaties. See, for example, section 11 of the 1942 Protocol to the U.S.-Canada income tax treaty.

Second, the proposed tax on unrealized capital appreciation would result in U.S. investors competing in the same industry, and otherwise similarly situated with respect to their Canadian investments, receiving significantly different tax treatment. Those U.S. investors in closely held Canadian corporations would not be subject to the adverse results described above which would be faced by a 25 percent or more U.S. shareholder in a widely held Canadian corporation.

U.S. investors who have in the past complied with the degree of Canadian ownership program would now be discriminated against under the White Paper proposals. Moreover, enactment of the tax on unrealized appreciation with respect to a substantial interest in a widely held Canadian corporation would be inconsistent with continuation of the concept of fostering a degree of Canadian ownership in Canadian subsidiaries of foreign investors. Since trading in such shares of Canadian subsidiaries, even on an over the counter

basis, would constitute the subsidiary a widely held Canadian corporation, there will be little incentive for a U.S. investor to solicit participation of Canadian investors in their wholly owned Canadian subsidiaries.

From a tax standpoint, a U.S. investor would probably be reluctant to invest in a 25 percent or more interest in a Canadian corporation unless he could be assured of 100 percent ownership in order to protect himself from tax on unrealized gain. Application of the tax on unrealized appreciation in shares of widely held corporations to nonresidents could impede capital formation in Canada which the White Paper recognizes is essential to Canada's growth. Moreover, nonresident investors owning stock in widely held corporations would be encouraged to withdraw funds by way of dividend distributions to depress the value of such stock and thereby minimize the tax on unrealized appreciation.

Termination of Canadian Residence

The White Paper proposes that when a taxpayer gives up Canadian residence he would be treated as if he had sold all his assets on that day at fair market value and the unrealized appreciation would be taxed at regular Canadian rates.

In addition to presenting great enforcement problems, this proposal would severely curtail the mobility of technical and managerial personnel. Enactment of this provision would make U.S. citizens most reluctant to accept a Canadian assignment. As a result, their knowledge, technology and experience would be lost and could not therefore assist in fostering Canada's economic growth. Correspondingly, Canadians would probably be hesitant to take up

temporary residence abroad to gain technical and managerial expertise which could then be utilized upon their return to Canada to the ultimate benefit of the Canadian economy.

The tax problems discussed above with respect to taxing unrealized appreciation accruing to a U.S. corporate investor owning 25 percent or more of the stock of a widely held Canadian corporation apply with equal force in the case of a U.S. citizen returning to the U.S. after employment in Canada and indeed, may be more severe. Even if a tax on unrealized appreciation was otherwise creditable against U.S. tax, the U.S. citizen subject thereto would presumably have little or no other foreign source income not already sheltered by foreign tax credit. Therefore, such Canadian tax would not be creditable against U.S. tax and the payment of such tax would seriously deplete the U.S. citizen's financial resources.

As a result of these proposals, the U.S. citizen might be required to sell assets (which would then become subject to U.S. tax) in order to obtain funds to pay the Canadian tax (which might not be creditable). Since the tax would apply to all of the U.S. citizen's assets, including various vested and non vested rights in stock purchase, pension and other deferred compensation plans of the U.S. employer corporation as well as to other assets having no relation to or nexus with Canadian taxation, the amount of the forced sale and accompanying hardship could well be large.

In addition, these proposals would create immense valuation problems for the U.S. citizen. Thus, the value of all of a U.S.

citizen's assets, whether or not related to Canada, would have to be established once upon entering Canada and again upon departure.

Treaty Withholding Rates

The White Paper proposes that Canada will increase its rate of withholding tax on income flowing to foreigners to 25 percent but will be prepared to reduce such rate on income flowing to residents of a country with which Canada has an income tax treaty to 15 percent, on a reciprocal basis.

The proposed withholding rates set forth in the White Paper are higher than those adopted in the typical developed country income tax treaties and in the OECD Draft Model Income Tax Treaty to which Canada has assented upon becoming a member of the OECD. As stated, the more recent U.S. income tax treaties with the developed countries generally provide for reciprocal exemption from withholding on capital gains, interest, and royalties and for a reduced withholding rate of 5 percent on intercorporate dividends.

A given foreign investment of a U.S. corporation must be competitive with other domestic investment as well as with the investment of foreign investors incorporated in jurisdictions which adopt the principle of territoriality, i.e., the exemption of foreign source income. Since the effect of section 904 of the Code is to insure that for purposes of U.S. taxation foreign source income is taxed at the greater of the U.S. or effective foreign tax rate, a U.S. investor would be reluctant to invest in those countries where the effective tax rate would be significantly higher than the prevailing U.S. rate.

Under the peculiarities of the U.S. foreign tax credit computation, the effective foreign tax rate on foreign source income, including investment income, is increased by the allocation of indirect expenses having no relationship thereto. For example, even with a reduced 5 percent rate of withholding on intercorporate dividends, excess foreign tax credits will result where the foreign corporate income tax rate is 50 percent. Assume that a wholly owned French subsidiary of a U.S. corporation earns $100 which is subject to French income tax of 50 percent, the remainder of which is distributed as a dividend. Pursuant to Article 9(2)(b) of the U.S.-France income tax convention, French withholding would be at the reduced rate of 5 percent, producing an overall French tax burden of 52½ percent on such dividends. Assuming a U.S. income tax rate of 50 percent, excess foreign tax credits in the amount of $2.50 will result even without consideration of U.S. expense allocations under section 904 of the Code. Assuming a 15 percent rate of withholding, similar to that proposed by the White Paper, the dividend would bear an overall tax burden of 57½ percent, producing excess foreign tax credits of $7.50 prior to expense allocation.

From the foregoing, it is apparent that withholding tax rates which range upwards of accepted international norms place a severe burden on the U.S. investor and could well increase the total after tax cost of a given foreign investment to the point where it ceases to be competitive with other investment opportunities available to the investor.

Accordingly, the Council would hope that income tax treaty withholding with respect to investment income, including capital gains not effectively connected with a permanent establishment maintained by the U.S. investor in Canada, will be based upon the exemptions from or reductions in withholding tax adopted in the developed country income tax treaties.

Withholding on Stock Dividends

Under present law, Canadian residents are required to pay tax on capitalizations of undistributed income (including stock dividends). Stock dividends distributed to non resident shareholders in Canadian corporations are subject to a 15 percent withholding tax. The White Paper apparently would continue to impose a withholding tax on stock dividends.

From the U.S. investor's standpoint, the receipt of a stock dividend under section 305 of the Code generally does not result in the realization of income for U.S. tax purposes. As a practical matter, the stock dividend tax might not be creditable, resulting in an additional tax burden on the U.S. investor's investment similar to that resulting from taxing unrealized capital appreciation in stock of widely held Canadian companies.

From Canada's standpoint, eliminating a tax on stock dividends would encourage dedication of earnings and profits to capital stock account. This would freeze large amounts of earnings which would not be remitted in cash abroad. Hence, the Canadian balance of payments would tend to improve.

Since the White Paper proposes to tax capital gains, there does not appear to be any further justification for imposing a withholding tax on stock dividends paid to nonresidents. Accordingly, the Council recommends that stock dividends paid to nonresidents not be subject to withholding.

Thin Capitalization

The White Paper proposes to restrict the deductibility of non-arm's length interest wherever the ratio of debt to stock exceeds 3 to 1.

Discrimination. Since this proposal is set forth at paragraph 6.41 of the White Paper in the section dealing with the Canadian tax treatment of nonresidents, it appears that only a Canadian corporation controlled by nonresidents is to be subject to the stringent capitalization proposals. If true, this seems clearly a discrimination against the nonresident investor in violation of section 11 of the 1942 Protocol to the U.S.-Canada income tax treaty.

Even if the White Paper would include the stockholdings of both foreign and Canadian stockholders in applying the 3 to 1 debt-equity ratio, a violation of the anti-discrimination provisions of section 11 of the 1942 Protocol to the present U.S.-Canada income tax treaty would seem to result. Under the integration proposals of the White Paper, Canadian stockholders will receive credit for the taxes paid by their Canadian company with respect to certain dividends. It would therefore be inequitable to allow such Canadian stockholders to credit the additional Canadian corporate tax resulting from the disallowed interest on foreign stockholder loans where the U.S. shareholder would not be permitted such relief.

Unduly Restrictive. Adoption of a mere mechanical debt to equity test appears arbitrary and far exceeds the U.S. rule to which the U.S. investor is now subject. Under U.S. concepts, the ratio of debt to stock is merely one of several factors used in determining whether a bona fide corporate indebtedness is present.*

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* While section 385 of the Code, as added by section 415 of the Tax Reform Act of 1969(P.L. 91-172), authorizes the Secretary of the Treasury to promulgate regulations distinguishing debt from equity, the statute clearly indicates that the ratio of debt to equity is but one of several factors taken into account in making such determination.

Adoption of an automatic, mechanical ratio of debt to stock as the sole criterion for determining whether indebtedness is bona fide is not in accord with accepted international norms and will not tend to encourage the continued free flow of foreign capital into Canada, as envisioned by the White Paper. For example, assuming an otherwise bona fide interest payment of $100 to its U.S. parent, and further assuming a Canadian corporate tax rate of 50 percent and a withholding rate of 15 percent, such interest payment will bear an overall Canadian tax of 65 percent. Disallowance of otherwise bona fide interest deductions resulting from the application of such mechanical ratio will create excess foreign tax credits for the U.S. investor, increasing the overall tax burden on his Canadian investment. The adoption of such a rule would be particularly burdensome with respect to the capitalization of new ventures where start up costs are generally high and where capital impairment could result.

The adoption of such a mere mechanical test ignores business realities, where for example, the U.S. investor, because of its high credit rating, is able to borrow at lower interest rates than could the Canadian company to which the loan is made. Similarly, such a test would fail to recognize the business requirements of particular industries, such as real estate and finance where debt-equity ratios as a matter of course are considerably higher than that proposed.

If a statutory mechanical test for the determination of indebtedness is to be adopted, third party loans to the company should be ignored in calculating the ratio. Further, the Council would hope that the apparent intention of the Government to use par value of the stockholder's equity in

calculating the ratio would be abandoned. Otherwise, a company which has operated successfully for many years would experience great hardship since the value of the stockholder's equity may be many times the par value of the stock. The underlying value of the stockholder's equity should be used as the measure in calculating the 3 to 1 ratio.

Branch Profits

It appears that the branch profits tax will be increased to 25 percent along with withholding on dividends paid to nonresidents of Canada. Under the White Paper, the dividend withholding tax will be reduced to 15 percent by treaty.

Accordingly, it should be made clear that Canada's treaty with the U.S., as renegotiated, will similarly reduce the branch profits tax, which would otherwise constitute an income tax excluded from treaty coverage. Otherwise, an unfair tax burden would be placed upon branch profits.

Nonresident Owned Corporations

The present law provides that nonresident owned investment corporations (NRO's) are taxed at a flat rate of 15 percent in accordance with section 70 of the Income Tax Act. The proposals in the White Paper state that the tax would be increased "to match the rate of the nonresident withholding tax".

The White Paper proposes two general levels of withholding tax -- 15 percent for treaty countries and 25 percent for other countries. Thus the meaning of the NRO proposal is unclear.

It appears logical to the Council to retain the existing 15 percent rate where the shareholders and holders of the funded indebtedness of an NRO are treaty country residents.

APPENDIX "B"

NAME: NATIONAL FOREIGN TRADE COUNCIL

SUBJECT: Taxation of Unrealized Gains
Treaty Withholding Rates
Stock Dividends
Thin Capitalization
Branch Profits
Non resident Owned Corporations

Analysis of Appendix "A" by Senior Advisor

This Brief is submitted by the National Foreign Trade Council, a private non profit organization of over 600 United States companies engaged in foreign commerce.

The Council was organized in 1914 to promote and protect American foreign trade and investment.

The Council has limited its remarks to the effect which the White Paper proposals are likely to have on United States investment in Canada, specifically, the Brief states: "it is appropriate to discuss the White Paper within the context of the problems of international double taxation faced by the U.S. investor".

The proposals discussed in the Brief are:

(1) Taxation of deemed realized gains in widely held stock.

(2) Taxation of deemed realized gains on termination of Canadian residence.

(3) Treaty withholding rates.

(4) Withholding on stock dividends.

(5) Thin capitalization.

(6) Branch profits.

(7) Non resident owned corporations.

The Brief is divided into the following parts:

(1) General remarks upon the history and objects of the Council and the possible effects of the White Paper proposals upon United States investment in Canada. (Pages 1 to 3 of the Brief).

(2) A summary of the taxation by the United States of foreign income received by its citizens and corporations. (Pages 3 to 5 of the Brief).

(3) Deemed realization of gains in widely held stock. (Pages 6 to 11 of the Brief).

(4) Termination of Canadian residence. (Pages 11 to 13 of the Brief).

(5) Treaty withholding rates. (Pages 13 and 14 of the Brief).

(6) Withholding on stock dividends. (Pages 15 of the Brief).

(7) Thin capitalization. (Pages 15 to 18 of the Brief).

(8) Branch profits. (Pages 18 of the Brief).

(9) Non resident owned corporations. (Page 18 of the Brief).

The Brief does not attempt to make recommendations, it merely points out the adverse consequences which could result if the White Paper proposals were to be implemented.

The attention of the Committee is drawn to the following remarks:

(1) "The U.S. asserts jurisdiction to tax the worldwide income of its citizens and corporations. Such jurisdiction is based upon U.S. citizenship or incorporation and not upon residence. Correspondingly, for over fifty years, the U.S. has permitted its citizens and corporations having fiscal responsibilities to two national jurisdictions to credit under section 901 of the Internal Revenue Code of 1954, as amended (hereinafter referred to as the "Code") against the U.S. tax otherwise payable any direct income taxes paid to the other tax jurisdiction. Under section 902 of the Code, a domestic corporation upon receipt of a dividend

from a 10 percent or more owned foreign corporation is deemed to have paid and thus have available as a credit a portion of the foreign taxes paid or deemed to have been paid by the foreign subsidiary to any foreign country or U.S. possession on or with respect to the accumulated profits out of which such dividends were paid." (Page 3 of the Brief).

(2) "While the foreign tax credit mechanism presents a practical solution to the problems of international double taxation, it should be stressed that full relief therefrom is not always attainable." (Page 4 of the Brief).

(3) "From the standpoint of the U.S. investor, the tax on the deemed realization of otherwise unrealized gain on a substantial interest in shares of widely held Canadian corporations constitutes one of the most detrimental and discriminatory proposals of the White Paper." (Page 6 of the Brief).

Name: NATIONAL FOREIGN TRADE COUNCIL

Principal Subject: Capital gains - 5 year revaluation

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Pages 6 to 11 of the Brief.
	6.43 The general proposal to include capital gains in taxable income would require changes to the international provisions, including the extension of Canadian tax to gains by non-residents on the disposal of real property, partnership interests and branch assets in Canada.	The Brief points out: (1) From the standpoint of the U.S. investor, the tax on the deemed realization of otherwise unrealized gain on a substantial interest in shares of widely held Canadian corporations constitutes one of the most detrimental and discriminatory proposals of the White Paper. (Page 6 of the Brief)
	6.44 Given the ease with which a gain on the sale of other assets can be transformed into a gain on the sale of shares of a corporation, it would also be necessary to tax certain gains by non-residents on the sale of Canadian shares. This need is strongly reinforced as regards closely-held Canadian corporations by the implications of the regime suggested for Canadian shareholders of those corporations. Since a Canadian can obtain full credit for the Canadian corporate tax paid by the corporation, and can deduct the full cost of his shares from his income when he sells those shares, he can afford to pay the full value of the corporation's assets (including creditable tax as an asset) when he buys the shares of the corporation.	(2) At the outset, the basic question arises as to whether a tax on income deemed to be, but not actually realized, would be considered tax for U.S. foreign tax credit purposes. However, as pointed out below, even if such tax could be considered a creditable tax, those U.S. investors subject thereto would still encounter severe economic hardships. (Page 6 of the Brief). (3) Mere unrealized appreciation in value of stock will not result in the realization of taxable income for U.S. purposes. Thus, a U.S. taxpayer subject to Canadian tax with respect to deemed realized capital gain (i.e. unrealized capital appreciation) on shares in widely held Canadian corporations would have no income from this source against which a foreign tax could be utilized. (Page 7 of the Brief). (4) Although U.S. direct investment is generally made on a permanent basis, the recurring 5 year tax on unrealized appreciation might result in forced sales in order to generate sufficient income with which to pay the tax where there is little or no market for the stock sold. This would result in great hardship to the U.S. investor and would dilute its equity position beyond that contemplated when the investment was made. (Page 8 of the Brief).

Name: NATIONAL FOREIGN TRADE COUNCIL

Principal Subject: Capital gains - 5 year revaluation

Present Tax Law	White Paper Proposals	Principal Points of Brief
		(5) The treatment of losses with respect to the tax on unrealized capital appreciation is particularly vexatious. (Page 8 of the Brief).
	6.47 The same implications do not apply in the case of widely-held Canadian corporations. Canadian shareholders would receive credit for only half of the corporate tax paid and would be entitled to deduct only half of their loss on the sale of their shares. Also, it would be impracticable to attempt to tax non-residents on their sales of small lots of these shares. Therefore it is proposed that only those non-residents who are selling shares out of a substantial interest (25 per cent or more) would be taxable in Canada.	(6) The proposed tax on unrealized capital appreciation would result in U.S. investors competing in the same industry, and otherwise similarly situated with respect to their Canadian investments, receiving significantly different tax treatment. Those U.S. investors in closely held Canadian corporations would not be subject to the adverse results described above which would be faced by a 25 percent or more U.S. shareholder in a widely held Canadian corporation. (Page 10 of the Brief).
		(7) U.S. investors who have in the past complied with the degree of Canadian ownership program would now be discriminated against under the White Paper proposals. (Page 10 of the Brief).
		(8) Nonresident investors owning stock in widely held corporations would be encouraged to withdraw funds by way of dividend distributions to depress the value of such stock and thereby minimize the tax on unrealized appreciation. (Page 11 of the Brief).
		The Brief in considering the U.S. - Canada treaty provisions points out:
		(1) Inasmuch as Article VIII only proports to deal with gains derived from the sale or exchange of a capital asset, a question arises whether Article VIII would offer immediate protection to the U.S. investor subject to the proposed tax on unrealized appreciation in the shares of a widely held corporation.
		The Council assumes that Article VIII as presently constituted will apply and afford the U.S. investor an exemption from the tax on unrealized appreciation in shares of widely held corporations. (Page 9 of the Brief).

Name: NATIONAL FOREIGN TRADE COUNCIL

Principal Subject: Capital gains - 5 year revaluation

Present Tax Law	White Paper Proposals	Principal Points of Brief
		(2) The Council assumes that Article VIII as presently constituted will apply and afford the U.S. investor an exemption from the tax on unrealized appreciation in shares of widely held corporations. (Page 9 of the Brief). (3) Moreover, the Council must point out that due to the severe hardships that would result to the U.S. investor, it would be forced to strongly oppose a subsequent change in Article VIII to remove this protection from any tax on unrealized capital appreciation. (Page 9 of the Brief). (4) The recurring 5 year tax on unrealized capital appreciation with respect to a substantial interest in a widely held Canadian corporation does not apply to Canadian shareholders in such corporation who are widely held Canadian corporations. On the other hand, the tax clearly would apply to the U.S. corporate investor who is a shareholder in the same corporation. Unless the contemplated income tax treaties which Canada will enter into after enactment of the White Paper proposals provide to the contrary, this would seem to be a clear violation of the typical antidiscrimination treaty clause adopted in the developed country income tax treaties.(Pages 9 & 10 of the Brief).

Name: **NATIONAL FOREIGN TRADE COUNCIL**

Principal Subject: **Termination of Canadian Residence**

Present Tax Law	White Paper Proposals	Principal Points of Brief
	3.36 The proposal that the accrued gains or losses on those shares be taken into account every five years is one of two exceptions to the general rule that capital gains and losses would be taxable only when they are realized. (The other exception concerns taxpayers who leave Canada.) Periodic revaluation would reduce somewhat the value of the half-gains rule. It would reflect the fact that these shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily at the time of his choosing. The shares of private companies do not have the same marketability. 3.40 The other deemed realization would occur when a taxpayer gives up Canadian residence. The general rule would be that he would be treated as if he had sold all his assets on that day at their fair market value. On the other hand, when a taxpayer moves to Canada he would generally be treated as though he had on that day purchased his assets at their fair market value. The combination of these two rules would mean that Canada would tax only the increase in value that arises during the time that the owner is resident in Canada.	Pages 11 to 13 of the Brief The Brief points out: (1) In addition to presenting great enforcement problems, this proposal would severely curtail the mobility of technical and managerial personnel. (Page 11 of the Brief). (2) The proposal would create immense valuation problems. (Page 12 of the Brief). This part of the Brief points out that the tax problems discussed with respect to taxing unrealized appreciation in shares would apply equally to the problems on termination of Canadian residence these problems are not repeated.

Name: NATIONAL FOREIGN TRADE COUNCIL

Principal Subject: Treaty Withholding Rates

Present Tax Law	White Paper Proposals	Principal Points of Brief
	1.45 The Income Tax Act sets out the basic international elements of Canada's income tax. Modifications are made by negotiated tax treaties with other countries. The present reform proposals will involve renegotiation of such treaties as well as revision of the act.	Pages 13 and 14 of the Brief The Brief points out that the proposed withholding rates are higher than those adopted in the typical developed country income tax treaties and in the OECD Draft Model Income Tax Treaty to which Canada has assented upon becoming a member of OECD. (Page 13 of the Brief).
	1.46 Relatively little change is proposed in the structure of taxes imposed on the Canadian income of people or corporations in other countries. However, to meet the problem presented by the diversion of income to "tax-haven" countries, the basic rate of withholding taxes set by the Income Tax Act on interest, dividends, rentals, and royalties paid or credited to non-residents would be increased to 25 per cent from 15 per cent. This increase would not override the rates in our existing treaties. Further, the 25-per-cent rate would generally be reduced in new treaties to the current levels, usually 15 per cent. Some new safeguards would be introduced to ensure that corporate income in	The Council would hope that income tax treaty withholding with respect to investment income, including capital gains not effectively connected with a permanent establishment maintained by the U.S. investor in Canada, will be based upon the exemptions from or reductions in withholding tax adopted in the developed country income tax treaties. (Page 14 of the Brief).

Name: **National Foreign Trade Council**

Principal Subject: **Treaty Withholding Rates.**

Present Tax Law	White Paper Proposals	Principal Points of Brief
	Canada is not reduced artificially by making payments in the form of interest and royalties to non-resident shareholders or related companies, instead of paying dividends. Pensions paid from Canada to persons living outside would be subject to a withholding tax of 25 per cent, but with provision for lower or higher rates if the circumstances of the recipient warrant. This is proposed because it is planned to maintain tax exemptions for contributions to registered pension plans and the investment income of such plans in the expectation that payments out of the pension funds will be taxable income. 2.26 Under our tax treaties with Britain, the United States and a number of other countries, professors and teachers who have come to Canada temporarily are exempt from Canadian income tax on their teaching salaries for two years. In some circumstances they are not taxed by the country where they are normally resident. Given the present scale of salaries of professors and teachers this arrangement is unjustified. We intend to remove this exemption, on a reciprocal basis, from our treaties and to tax such persons like others.	

Name: NATIONAL FOREIGN TRADE COUNCIL

Principal Subject: Withholding on Stock Dividends

Present Tax Law	White Paper Proposals	Principal Points of Brief
		Page 15 of the Brief The Brief points out: (1) From the U.S. investor's standpoint, the receipt of a stock dividend under section 305 of the Code generally does not result in the realization of income for U.S. tax purposes. As a practical matter, the stock dividend tax might not be creditable, resulting in an additional tax burden on the U.S. investor's investment similar to that resulting from taxing unrealized capital appreciation in stock of widely held Canadian companies. (2) From Canada's standpoint, eliminating a tax on stock dividends would encourage dedication of earnings and profits to capital stock account. This would freeze large amounts of earnings which would not be remitted in cash abroad. Hence, the Canadian balance of payments would tend to improve. (3) Since the White Paper proposes to tax capital gains, there does not appear to be any further justification for imposing a withholding tax on stock dividends paid to nonresidents. Accordingly, the Council recommends that stock dividends paid to nonresidents not be subject to withholding.

Name: **NATIONAL FOREIGN TRADE COUNCIL**

Principal Subject: **Thin Capitalization**

Present Tax Law	White Paper Proposals	Principal Points of Brief
	6.41 The Canadian tax system contemplates that non-residents who earn business profits in Canada shall pay income tax to Canada at the rates that apply to Canadians. If a foreign individual carries on business in Canada, he is taxed on the profits in accordance with the normal table of progressive rates. If a foreign corporation carries on business here, it is taxed on the profits at the corporate rate of 50 per cent. If the foreign corporation incorporates a Canadian subsidiary, the Canadian corporation is taxed on the profits at 50 per cent, provided the foreign corporation makes its investment in the form of shares. If, however, the foreign corporation makes part of its investment as a loan, the interest on that loan is a deduction in computing business profits. It therefore saves tax at 50 per cent, but it bears Canadian tax only at the withholding rate of 15 per cent (or 25 per cent if not protected by treaty). It is a natural thing for corporations to borrow, and not unnatural for them to borrow from their shareholders, but the difference in tax rates has tempted some to create corporations with very nominal share capital (say $3) and to make virtually all of their investment as an interest-bearing loan.	<u>Pages 15 to 18 of the Brief</u> The Brief points out that this proposal appears to apply only to Canadian corporations controlled by non residents, and if this be so, then it seems clearly a discrimination against the non resident investor in violation of Section 11 of the 1942 Protocol to the U.S.-Canada income tax treaty. (Page 16 of the Brief). The Brief points out that in the U.S. Code, the ratio of debt to stock is merely one of several factors used to determine whether a bona fide corporate indebtedness is present. (Page 16 of the Brief).

Name: NATIONAL FOREIGN TRADE COUNCIL

Principal Subject: Branch Profits.

Present Tax Law	White Paper Proposals	Principal Points of Brief
	6.48 A foreign corporation which carries on business in Canada through a branch is liable for a special 15-per-cent tax on net after-tax profits it has available for withdrawal from Canada. This tax is counterpart to the 15-per-cent withholding tax applied to dividends paid by Canadian corporations to foreign shareholders. The rate would be increased in parallel with the change in the withholding rate on dividends.	Page 18 of the Brief The Brief points out that the branch profits tax should not exceed the rate set by treaty.

APPENDIX "C"

COMMENTS
ON THE
PROPOSALS FOR TAX REFORM

ASSOCIATION OF INTERNATIONAL
BUSINESS CORPORATIONS

INDEX

SUMMARY

The Association of International Business Corporations (IBC) represents internationally oriented Canadian corporations which, in addition to their home market activities, carry on substantial foreign business, either directly or through subsidiaries. In view of this specialized interest, this brief deals only with those areas of the White Paper which adversely affect Canadian companies with international business activities or their shareholders.

Our members submit that, if Canadian multi-national companies are to remain in a position to continue their important contributions to the Canadian economy and to raise needed capital at home and abroad, our tax system should recognize these principles:

i) Internationally active Canadian companies should not be placed in a more difficult position, either with respect to their own operations or vis-à-vis their shareholders, than Canadian companies doing substantially all their business in Canada; and

ii) Canadian corporations should not be placed in a worse productive, trading or tax position outside Canada than competitive entities of other countries bidding for the same business.

In conformance with these principles, the IBC urges the following:

1. Retention of the present rule permitting tax-free receipt of dividends from subsidiaries.

2. Rejection of the White Paper proposal to introduce complicated rules, akin to Subpart F of the United States Internal Revenue Code, for the purpose of taxing "passive income" of foreign subsidiaries.

3. Rejection of the White Paper proposal to limit credit for foreign withholding taxes to fifteen per cent.

4. Extension of rollover privileges to reorganizations including foreign operations.

5. Adoption of an adjusted cost basis system for controlled foreign corporations.

6. Retention of the present tax credit regime for dividends paid by Canadian corporations and rejection of the White Paper proposal to replace this regime by a complicated integration scheme.

7. Rejection of the White Paper proposal to impose capital gains tax on substantial foreign shareholders of Canadian corporations.

8. Rejection of the proposed five-year revaluation tax for domestic and foreign shareholders of widely held Canadian corporations.

The White Paper proposals, which our members urge the Committee to reject, can be classified as follows:

1. Entirely novel ideas which appear to be untried and without precedent. This includes the proposed limitation of credit for foreign withholding tax, refusal of rollover privileges for foreign reorganizations, and the five-year revaluation tax.

2. Proposals which worked out poorly in the countries which originally adopted them and which these countries have now abolished or are now in the process of abolishing. This includes the dividend integration scheme and the proposal to introduce Subpart F type rules in Canada.

3. Measures which would countervail generally accepted international policies and practices of taxation. This would include taxation of capital gains of substantial foreign shareholders, including five-year revaluation tax on unrealized gains.

GENERAL INTRODUCTION

The Association of International Business Corpora tions (IBC) is an association of internationally oriented corporations which are resident in Canada, and, in addition to their home market activities, carry on substantial foreign business, either directly or through subsidiaries. The types of business carried on by multi-national Canadian companies comprise a substantial and highly diversified portion of the industrial and commercial segment of our society. Among the members of IBC are publicly listed and privately held companies, companies controlled in Canada and outside of Canada, industrial companies and financial companies, all of whom have, however, the single common denominator of carrying on a substantial portion of their profit making business outside of Canada, either directly or through partially or wholly owned subsidiary companies, which, for the most part, are incorporated outside of Canada.

The purpose of this brief on the White Paper Proposals for Tax Reform (the White Paper) is to comment on a number of the areas of the White Paper which adversely affect international business activities of Canadian companies and, in the opinion of the members of the IBC, should be amended or eliminated.

While, in one way or another, the whole of the White Paper may be said to impinge upon the activities of the various IBC members, this brief does not intend to discuss the general aspects of the White Paper. Instead, this presentation is limited to a specific review of the effects which the White Paper would have on the foreign activities of IBC members. This is not to say that the membership thereby automatically accords with the provisions of the White Paper not specifically dealt with herein, but the members felt that a more limited approach is necessary and desirable for a constructive review of the international aspects of the White Paper.

The problems which the White Paper creates for the members of the IBC may be roughly divided under these major headings:

I. The problems which our members face under the White Paper by virtue of business which they conduct outside Canada directly or through affiliates;

II. The problems which the shareholders of our members face under the White Paper (a) by virtue of the above foreign business activities of our members or (b) because such shareholders may not be residents of Canada.

Although there is a necessary amount of overlapping within these headings, this brief proposes to so divide the presentation.

I.

WHITE PAPER PROBLEMS RELATING TO FOREIGN BUSINESS OPERATIONS OF CANADIAN COMPANIES.

Introduction

This heading deals with the various White Paper proposals which directly affect our business relations with and in foreign countries. Within this general area lie problems related to (a) production of Canadian factories which is exported and sold in its original state or after subsequent processing, finishing or packaging in a Canadian owned foreign factory and (b) production of Canadian owned foreign factories, the profits of which are, in due course, in whole or in part repatriated to Canada. The contribution of these activities to the Canadian economy is most substantial. With respect to (a) above, one-half of all the goods produced in Canada are sold to foreign countries. In 1968, 49.2% of the output of our goods producing industries was exported, and this output constituted 24.7% of our gross national production. When this substantial aspect of our national economy is added to the production and sales activities which Canadian controlled entities carry on abroad, it is evident that any change in the existing tax system which impedes these activities will cause serious detriment to the Canadian economy as a whole.

Section 6.9 of the White Paper recognizes that Canadian business "is often required to go abroad to seek foreign sources of supply and to develop foreign markets... to achieve the economies of scale which are otherwise denied them by the relatively small size of the Canadian domestic market" and that Canadian companies "would find it hard to compete on the international scene if they were subject to more onerous taxes than those which apply to their competitors." The members of the IBC do not ask for anything more than a tax system which will result in the foregoing.

Canada does not give substantial incentives to Canadian companies which serve the export trade or establish foreign operations, and it is outside the powers of Canada to demand that other countries play the game according to Canadian rules.

While most members feel that the Canadian tax system should actually encourage Canadian companies to be active internationally because of the very substantial benefits to our economy and because our foreign competitors receive support by their home countries, this Brief, limited to the context of the White Paper, urges only that no tax measures be implemented which would frustrate achievement of the above objectives.

This would require recognition of these two principles in our tax system:

i) Internationally active Canadian companies should not be placed in a more difficult position, either with respect to their own operations or vis-à-vis their shareholders, than Canadian companies doing all or substantially all their business in Canada; and

ii) Canadian corporations should not be placed in a worse productive, trading or tax position outside Canada than competitive entities of other countries bidding for the same business.

A number of aspects of the White Paper conflict with these principles and the members of the IBC ask modification or elimination of the following proposals:

1. The proposal in Section 6.15 to eliminate tax exemption for dividends from subsidiaries in non-treaty countries;

2. The proposal in Section 6.21 to tax so-called "passive income" of foreign subsidiaries, in a manner similar to Sub-Part F of the United States Internal Revenue Code.

3. The proposal in Section 6.22 and 6.29 to limit the foreign tax credit;

4. The proposal in Section 3.47 to exclude foreign corporations from tax-free rollovers; and

5. The proposal in Section 6.19 on cost basis of controlled foreign corporations and the general subject of the deductibility of interest, unless it becomes part of a general adjusted cost basis regime.

1. The Proposal in Section 6.15 to Eliminate Tax Exemption for Dividends from Subsidiaries in Non-Treaty Countries

Section 6.15 proposes to continue the present system of exempting dividends from foreign corporations if the dividend recipient owns 25% or more of the voting shares of the foreign corporation, but to limit the exemption to dividends from countries with which Canada maintains bilateral tax treaties. Canada at present has income tax treaties with the United States, the United Kingdom, France, Spain, New Zealand, Ireland, Denmark, Germany, South Africa, the Netherlands, Australia, Belgium, Finland, Japan, Trinidad and Tobago, and Norway. Not more than one or two of these treaties are with underdeveloped countries. While the IBC has no way of exactly knowing why, it is apparent that it has been and will continue to be difficult for reasons of nationalism, political expediency and other factors, to conclude tax treaties with members of the "third world," which comprise the countries most desperately in need of private investment from countries like Canada.

While most developed nations are expanding aid and assistance to the under-developed areas of the world and valiantly try to induce the private sector of their economies to invest in and bring know-how to such countries, the White Paper proposals would actually be counter inducements by making it more expensive tax-wise to do business in such countries. Investment in under-developed countries involves

risks additional to those in mature economies. Further, rather than lesser incentives are needed to induce private investment to venture into these needy areas.

Removal of dividend tax exemption from 25% owned foreign companies (CFC's) because those companies are created under the laws of non-treaty countries will effectively bar private Canadian investment in under-developed countries, or, alternatively, force it to operate, for better or for worse, through treaty countries.

Beyond the foregoing, the result of adoption of this portion of the White Paper proposals would be to give or deny the foreign dividend exemption for reasons which appear to have no logical basis vis-à-vis Canada. Section 6.17 provides that Canadian parent corporations would receive credit for foreign withholding tax on dividends from non-treaty countries and foreign corporate tax on profits giving rise to such dividends. The effect would be to penalise those CFC's whose foreign taxes are not measured by a percentage of business profits, or which receive incentive benefits in one form or another to reduce foreign income taxes. Such CFC's would, therefore, find themselves in the peculiar position of having to influence foreign taxing jurisdictions to apply certain kinds of taxes, rather than others. If they do not succeed, they would suffer "confiscation" of their foreign benefits and incentives by Canadian income tax on their dividend income. This could effectively double their cost of doing business in non-treaty countries as compared to the cost of their foreign competition.

Our members realize that the drafters of the White Paper had in mind the so-called tax havens with which Canada would not sign tax treaties and in respect of which the proposal of the White Paper might therefore conceivably have some merit. It would, however, in our members' opinion be a grave mistake to affect the major part of the world's population through our tax policy, solely because we want to close limited tax loopholes which, as is hereafter set forth, are more properly corrected by existing means. Our members consider the assumption of Section 6.50 that "by far the greatest portion of international income is expected to fall within the treaty system" to be entirely unrealistic. This assumption could be achieved only if Canadian foreign investment is effectively limited to the fully developed areas where tax treaties exist, and this is not our national policy. The members of the IBC, therefore,

recommend that the present tax exemption for dividends from CFC's be retained without change.

2. The Proposal in Section 6.21 to tax So-Called "Passive Income" of Foreign Subsidiaries

The apparent purpose of the proposals on "Passive Income" in Sections 6.20 and 6.21 is to eliminate assumed abuses whereby so-called passive income (presumably meaning income not earned through bona fide business operations) is diverted so that it escapes otherwise properly assessable Canadian tax thereon. The White Paper uses the term "tax haven" rather liberally (see Sections 1.46, 1.47, 1.48, 6.20, 6.21, etc.) giving the impression that vast tax avoidance schemes are looming over the Canadian tax picture channelling millions of dollars away from properly assessable Canadian tax to the general detriment of the public. The suggestion for correction is "to introduce provisions based generally on those in the United States," notwithstanding that they involve "complicated and difficult law" (Section 6.21) and are not expected to raise revenue in excess of ten million dollars (Section 8.29).

While the spectre of tax havens is continually referred to in the White Paper, there is little detailed reference to exactly what type of tax avoidance schemes the Government is attempting to correct, and except for isolated examples, such as Section 6.19, and generalities, such as Section 6.20, this is left completely vague. It would appear that the primary areas which the Government might consider in this connection would be the use of off-shore companies (a) to step up the cost of property and inventory which are procured abroad and brought into Canada and to step down the price of property and inventory which are procured in Canada and sold abroad, and (b) to act as incorporated foreign pocketbooks for portfolio investments by Canadian residents. While these presumed tax avoidance schemes could be barred by rules similar to those in the United States Internal Revenue Code, we feel that the Government has sufficient remedies under present law to correct the above instances of tax avoidance as well as those generally referred to in Section 6.20. (See below)

The reference to United States law, presumably, concerns Subpart F of the Internal Revenue Code of the United States. Subpart F comprises Sections 951 to 964 and these are supplemented by Regulations 1.951-1 to 1.964-3 inclusive. The last CCH printing of the United States Internal Revenue Code requires some 22 pages of closely set type for the statute and 187 pages for the regulations. Even so, this does not represent all of the provisions pertaining to Subpart F. Other sections of the United States Internal Revenue Code are needed to interpret and supplement this material. Even though Subpart F was originally enacted in 1962, the United States Treasury is still unable to complete its regulations for this statute. There is now a considerable body of opinion in the United States, that on the whole, Subpart F has created far more disruption than benefits.

A frequently told story in United States tax circles is that there are less than ten tax experts in the United States who can understand all of Subpart F, but they are unable to explain it to anyone else and cannot agree among themselves as to what it in fact provides.

The Honourable Edwin S. Cohen, Assistant Secretary of the United States Treasury for Tax Policy, stated on November 19, 1969, in a speech before the Tax Association of the 56th National Foreign Trade Convention with respect to Subpart F, and, generally, the taxation of foreign source income:

> "First, the present law is far too complex. It is too complex for taxpayers and too complex for efficient administration..... the cost of complexity both to taxpayers and the government in this area is real, stemming largely from the necessity to assign large numbers of very intelligent people in an effort to make the present mechanism function. I think we should strive to shift some of this talented manpower both inside and outside of government away from such intricacies as Subpart F income... to work creatively on such critical needs as low income housing, transportation, legal services for the poor

and other frontiers of the law. I doubt that with our present detailed rules and regulations we really attain in the last analysis in the foreign area more than rough approximations of tax liability."

A further indication of the United States shift away from Subpart F are the present proposals to give tax-free status to "Domestic International Sales Corporations" (DISC) established within the United States for export of United States products. Establishment of tax-free export corporations in the United States in fact legalizes what Subpart F was to prevent. It would be an admission that Subpart F has hurt United States exports. Adoption of the DISC proposals in the United States would give United States exporters a tremendous advantage, especially if Canada's exports should be affected by Canada's adoption of Subpart F.

It seems to the members of the IBC that if the United States with the largest, best financed and most sophisticated revenue collecting system in the world at this moment effectively acknowledges the failure of Subpart F and the need to substantially change it, it would be unwise for Canada, with its smaller technical cadre, to attempt to parrot the United States rules.

Although, as noted before, the White Paper implies that the most important objective in the international tax field is to legislate against vast tax avoidance schemes and abuses, it also notes that even if all its proposals regarding taxation of "inactive income" were adopted, only ten million dollars annually would be added to our revenue. Our members strongly suggest that this potential ten million dollars will be many, many times exceeded by the dollar value of wasted manpower which would be diverted to computation, reporting and examination by industry and Government under rules similar to Subpart F. Moreover, for reasons hereinafter set forth, our members do not believe that any portion of Subpart F is necessary in order to prevent the so-called tax haven abuses implied by the White Paper.

Finally, the adoption of an equivalent to Subpart F

must, of necessity, be even more complex than the specific sections in the United States Internal Revenue Code. Subpart F makes cross reference to very substantial other segments of the Internal Revenue Code, without which it would be nonsensical. Perforce, the Income Tax Act of Canada would have to import these additional provisions into its statute. Also, the bite of Subpart F is largely mitigated by various other provisions of United States law, such as the option to choose between global and per-country tax credits, Export Trade Companies, Western Hemisphere Trade Corporations, etc. If the introduction into our law of an equivalent to Subpart F is to make any sense, we must also include all these attendant exclusions and variations in our Tax Act. Even if, hypothetically, Subpart F were desirable and even if the present law were inadequate, the very weight and complexity of legislation required to put Subpart F into effect would be self-defeating.

Our members maintain that any problems which may now exist with respect to tax havens and loopholes in international income are not due to lack of legislation, but lack of administration Our Income Tax Act and case law contain a multiplicity of principles which, if properly administered, can, in our opinion, effectively close the very loopholes and inconsistencies which the White Paper proposes to correct by new legislation. Our members are not convinced that further legislation will result in better administration. If the present rather simple rules cannot be effectively enforced, it is hard to understand why more complex rules should work more efficiently.

The present Income Tax Act and/or case law provides as follows:

a) Where a foreign corporation is effectively managed and controlled in Canada it is deemed to be a resident of Canada and taxed as an ordinary Canadian corporation. (The general case law);

b) Where a tax payer carrying on business in Canada purchases anything not at arms length at a price in excess of fair market value, he is deemed to have paid fair market value (Section 17(1));

c) Where a taxpayer carrying on business in Canada sells anything not at arms length at a price less than fair market value, he is deemed to have received fair market value (Section 17(2));

d) Where a taxpayer carrying on business in Canada pays to a non-resident not at arms length a price, rental, royalty, etc., for property, carriage of goods or passengers, or services more than a reasonable amount therefor, the reasonable amount is deemed to have been paid (Section 17(3));

e) Where a non-resident person pays to a taxpayer carrying on business in Canada not at arms length a price, rental, royalty, etc., for property, carriage of goods or passengers or services less than a reasonable amount therefor, the reasonable amount is deemed to have been paid (Section 17(4));

f) Where a taxpayer makes a deduction, disbursement or expense that unduly or artificially reduces income, it is disallowed (Section 137);

g) Indirect payments of benefits may be taxed, even if there is no intent to avoid or evade tax under the Income Tax Act (Section 137(2));

h) Where one of the main purposes of a transaction or transactions is improper avoidance or reduction of taxes, the Treasury Board may give such directions as it considers appropriate to counteract the avoidance or reduction (Section 138);

i) Where amounts are received by a taxpayer which result in substantial reduction or disappearance of corporate assets so that tax otherwise payable on income distribution has been avoided, a tax may be imposed (Section 138A);

j) Where two or more corporations are not used solely for business purposes and one of the main reasons for their separate existence is to reduce taxes they may be deemed to be associated (Section 138A(2));

k) Where indirect payments or property transfers are made pursuant to the direction or with the concurrence of a taxpayer to confer a benefit, the effect thereof may be eliminated (Section 16(1));

l) Where benefits are conferred on shareholders other than through accepted channels, they are taxable income (Section 8(1));

m) Where corporations are controlled by individuals or through families, the income of such personal corporations is directly taxed to the shareholders and the corporate form is disregarded (Sections 67-68).

These and other examples of statutory and case law show that the federal government and the Department of National Revenue have already available to them a complete arsenal of statutory authority to prevent abuse of tax havens, where warranted, and eliminate tax loopholes, where they in fact exist. The use of off-shore corporate shells to syphon off profits (in connection with exports or imports) and the use of "incorporated pocketbooks," is effectively preventable under present law by distinguishing between those off-shore companies which actually conduct a bona fide foreign business and those which are mere shells or devices, serving little other purpose than tax reduction.

Any failure to effectively enforce the law, if such should be the case, and the abuse of tax avoidance devices and loopholes, if they really exist in any substantial amount, are in the opinion of our members, no fault of the Income Tax Act, but rather, if they exist, either due to administrative shortcomings, or, alternatively, the fact that such enforcement is effectively impossible in foreign areas. It is erroneous to believe that expansion of present law and creation of numerous statutory and regulatory authorizations will automatically result in more efficient collection. It will probably result in less efficient collection. The history of all taxing statutes and the experience in the United States does not lead one to believe that complexity is a solution for previous inefficiency.

The members of the IBC recommend to the Committee that if abuses in fact exist in any large degree, Government be asked to explain exactly why they have been unable to use the tools at hand to avoid the specific loophole problems set forth in the White Paper. Why has the incorporated pocketbook abroad not been assessed as a resident company of Canada and/or, in appropriate instances, as a personal corporation? Why have off-shore subsidiaries that are mere paper companies and who charge non-market prices in the import and export trade not been assessed under Section 17? Why, in general, therefore, will the new law achieve what the old law could not? These questions, the members of the IBC feel, are important and proper.

Aside from the fact that the Government proposals will introduce unnecessary complexities in our Income Tax Act and complicate Canadian income tax reporting and collections on foreign transactions, our members are seriously concerned about the impact of these proposals on the competitive stance of Canadian companies abroad. In many instances, Subpart F type provisions interfere with bona fide business operations. Canadian companies, engaging in such operations through foreign subsidiaries would face additional tax costs from which their local competition is exempt. This is in addition to the tax compliance and reporting burdens, which involve considerable expense as well. That Subpart F impedes foreign trade of domestic companies has been realized in the United States and given rise to the current proposals to change Subpart F and introduce tax-free Domestic International Sales Corporations.

3. The Limitation of Section 6.22 and 6.29 on the Foreign Tax Credit.

Section 6.22 proposes to limit credit for withholding tax on foreign portfolio investments to 15%. Likewise, Section 6.29 proposes to limit to 15% the flow-through of foreign withholding tax to Canadian shareholders of Canadian corporations, regardless of whether the withholding tax relates to dividends from CFC's or foreign portfolio investments. This, presumably, is on the grounds that virtually all foreign investment will be from tax treaty countries and will, therefore, not suffer withholding tax in excess of 15%.

For reasons set forth in 1 above, our members feel that this assumption is not grounded in fact, or alternatively, that if the

proposed changes of the Canadian Income Tax Act should produce this result, it would be most unfortunate for the structure and role of Canada's world wide investment.

Taking into account private industry's natural profit motive, it seems clear that this proposal, if adopted, will ultimately limit Canadian investment to areas where withholding tax does not exceed 15%, thereby eliminating all other areas of the world. While, previously, the foreign withholding tax was an important and influential factor in investment decisions, there was the saving grace that investments in high withholding tax areas were not automatically ruled out because off-setting credits against Canadian income tax and tax-free capital gains were possible. With both these incentives eliminated, Canadian investment and related business activity in such areas will eventually dry up.

Restricting Canadian investment and attendant business activity to those parts of the world which agree with our ideas on what withholding tax rates are proper, creates these problems:

a) It vitiates our official policy of technical and investment support for less developed nations.

b) It invites foreign competitors to replace Canadian business, influence and capital in their traditional roles in many markets which are likely to show the highest relative growth in the balance of this century.

c) If intended to force other countries to adjust their withholding tax rates to ours, the policy is doomed to fail because of Canada's relatively minor position as a supplier of foreign capital.

The members of the IBC, therefore, recommend that the limitations on foreign tax credit in Sections 6.22 and 6.29 be eliminated.

4. Exclusion of Foreign Corporations from Tax-Free Rollovers as Proposed in Section 3.47

The Government admits that the purpose of Section 3.47, barring tax-free rollover privileges for foreign reorganizations, is expediency, not equity.

For the members of the IBC, virtually all reorganizations would, in one way or another, involve all or a part of their foreign subsidiaries. Companies engaged in international business have frequent need for corporate restructuring. To automatically exclude foreign corporations on the sole ground that the "provisions necessary to achieve the appropriate ultimate

result would be too complex" seems to our members much too cavalier to be acceptable. (See Section 6.21 of the White Paper where complexity is acceptable when the result is the imposition of tax).

Tax-free rollover privileges are granted by practically every industrial nation which imposes capital gains tax, regardless whether the reorganization is domestic or foreign. The United States now includes foreign corporations in its tax-free reorganization procedures with the permission of the Internal Revenue Service. In May 1968, the International Revenue Service published Revenue Procedure 68-23 establishing guidelines within which favourable private rulings will be issued for tax-free reorganizations.

The present thinking of the Treasury is to further liberalize the granting of rollover privileges to foreign corporations by removing the requirement of prior individual consent.

The Honourable Mr. Cohen said on this subject (op. cit.):

> "We do believe that there is a substantial question as to whether the retention of the advance ruling requirement is not an unwarranted impediment to the conduct of international business in view of the necessity for prompt action on business decisions. It does not seem to be a legitimate function of the tax laws to subject transactions, whether routine or major, to delays by requiring the obtaining of advance rulings where business necessity requires action and where a taxpayer is willing to take his chances as in other tax matters."

The members of the IBC subscribe fully to Mr. Cohen's comments. Sections 137 and 138 of the present Income Tax Act contain effective and flexible provisions permitting the Government to attack reorganizations which, through use of foreign corporations, are for improper tax avoidance purposes. This, our members believe, is the proper approach, rather than absolute elimination of foreign corporations from rollover provisions, which would have a very detrimental effect on the procedures of internationally oriented companies, destroying the very flexibility which is

essential to survive under the pressure of fluctutating environments and international competition and which is enjoyed by competitors from all major international trading nations.

5. Deductibility of Interest and the Proposal in Section 6.19 on Cost Basis of Controlled Foreign Corporations.

The White Paper does not explain how interest deductions will be treated under the proposed legislation. Our members feel that this should be remedied. If the current provisions of the Income Tax Act are to remain, they would produce considerable inequities if the White Paper proposals are adopted.

At present, interest is basically deductible, except when borrowed money is used to purchase assets, the income from which is exempt, or for personal purposes or to purchase property for personal use. If the White Paper comes into effect, no property of Canadian residents will be exempt from capital gains tax, and the test of exempt income will substantially change. For instance, dividends from fully tax paying Canadian companies to Canadian individuals and corporations will, in many instances be effectively free from tax, whereas dividends from non-tax paying Canadian companies will be taxable to individuals and corporations.

What, therefore, is the tax treatment of interest on borrowings to acquire shares of Canadian or foreign companies? Will it be deductible in all instances, non-deductible in all instances or deductible based on specific tests as to whether the particular company's dividends are taxable or non-taxable in any one year?

The criteria in the previous paragraph deal, however, only with the question of interest deductibility as a current expense and do not consider the question of adding interest and property taxes to the cost basis of assets for capital gains purposes. For instance, may interest on borrowings used to acquire personal property, if it should remain non-deductible in computing income, nevertheless be added to such property's capital cost for capital gains purposes?

The above questions are only a few of a very substantial number that could be asked in this area, none of which are covered by the White Paper. What little help can be derived from the White

Paper proposals is negative. For instance, Section 5.17 would specifically prohibit deduction of interest (as well as capital cost allowances and property taxes) from taxable income in specified cases.

While this, in the opinion of the IBC, is in itself unfair and unwarranted, it would seem at the very least that if these particular items are to be barred as deductions for income tax purposes, they should be added to the cost of the property for capital gains purposes. If this is not done, we would create a vast new area of "nothings," although the elimination of such "nothings", specifically in the case of depreciable property, is stated to be one of the purposes of the White Paper. (Sections 5.4 to 5.8)

Similar problems arise with respect to interest on Canadian corporations' borrowings used to acquire shares in CFC's. If the CFC's are in non-treaty countries, and their dividends are therefore taxable in Canada, will such interest be deductible in the future? Will the fact that capital gains in connection with sales and reorganizations of CFC's will in the future be taxable, have a bearing on this question? Finally, to the extent that interest on such borrowings will not be deductible, may it be added to the Canadian investor's cost basis of the foreign shares? Section 6.19 states that dividends from CFC's are to be deducted in computing loss on disposal. Similarly, interest and other expenses in connection with the holding in shares of CFC's, which are not currently tax deductible, should be added to the cost basis. Interest carrying costs on a Canadian company's investment in a CFC may easily equal or exceed the dividends paid by the CFC. A distorted result would arise if dividends must be deducted from cost while interest is disregarded.

The foregoing illustrates the inherent complexities accompanying imposition of capital gains tax in a developed economy.

The decision to integrate capital gains and capital losses into income requires detailed rules to determine adjusted cost basis, that is, the adjusted cost upon which the gain or loss is to be computed. In the United States Internal Revenue Code and the United Kingdom Finance Acts, these provisions and pertinent regulations (comprising also the sections and regulations on tax-free reorganization) comprise some of the most voluminous and

difficult matters in the whole of the United States and United Kingdom income tax law. The imperfection of even these extensive rules is shown by the libraries of case law and commentaries on this subject matter. Since, except for relatively few comments on so-called rollovers, this whole area has been disregarded in the White Paper, it is impossible for the members of IBC to determine whether or not the ultimate legislative results will be fair and workable. It is clear that without adequate and detailed legislation and/or regulations, the result can be grossly unfair and detrimental. Our members, therefore, submit that the Government should be required to explain in detail how they intend to proceed in this area, so that taxpayers in general may have an opportunity of commenting on the specific effects which the new regime will have on them.

II.

WHITE PAPER PROBLEMS AFFECTING SHAREHOLDERS OF CANADIAN COMPANIES WITH FOREIGN OPERATIONS.

Introduction

This heading deals with those White Paper proposals which directly impinge upon the shareholders of Canadian companies with foreign operations, such as the members of the IBC. The matters considered may affect domestic and foreign shareholders equally or differently as the analysis will show.

For reasons hereinafter set forth, the members of the IBC ask relief in respect of the following White Paper proposals:

1. The proposals in Sections 4.46 and 4.48 and Chapter 6, which would modify the present tax credit system on corporate distributions and would especially affect shareholders of companies with foreign income;

2. The proposal in Sections 6.46 and 6.47 to tax capital gains of substantial foreign shareholders on disposition of shares in Canadian companies; and

3. The proposal in Section 3.33 on the five-year revaluation rule.

1. Tax Credits on Corporate Distributions

Chapter 4 of the White Paper proposes to scrap the present tax credit system and substitute a complicated regime of flow-through tax credits for Canadian shareholders to integrate corporate and individual income tax with the theoretical aim of largely eliminating the difference between incorporated and unincorporated businesses and profits.

Whatever theoretical delight this systemic and symmetrical method may provide, experience shows that it has never worked well in any country.

To the best of the knowledge of the members of the IBC, only the United Kingdom and France have ever attempted this approach.

The United Kingdom first introduced such a scheme in the mid-1800's. It was retained for many years and differed from the White Paper proposals by providing more equal treatment to domestic and foreign shareholders. In recent years, the United Kingdom government concluded that the scheme no longer met modern requirements, not only because of its inherent complexity, but also because it tended to frustrate tax measures taken to pursue economic policy objectives, since such measures would lose their impact at the shareholder level. The system was therefore gradually abandoned. The end of the United Kingdom integration scheme came in April 1965, when the Chancellor of the Exchequer of the United Kingdom stated in his budget speech:

> "These changes (referring to the history of UK income tax) have made obsolete the idea that companies and individuals should be treated for tax in the same way...there should be a separate tax on the profits of corporations quite distinct from the income tax that is levied on distributed profits... as soon as it (corporate tax) is divorced from the taxation of individuals, we are free to draw it up on principles most conducive to economic growth and efficiency".

France only recently introduced an integration system for corporate distributions, but it has already run into considerable difficulty.

Since the French system, similar to the White Paper proposals, but unlike the United Kingdom scheme, originally denied integration benefits to non-resident shareholders, treaty partners complained of discrimination against their nationals. As a result, France had to change its position and, since January 1, 1970, integration benefits, including cash refunds of corporate taxes which qualify for integration, are available to

most foreign shareholders of French corporations.

As to the details of integration, the French, with their typical pragmatic approach to reforms, have greatly simplified the grossing up procedure. French law gives shareholders (including, since January 1970, foreign shareholders) an "avoir fiscal" or credit comprising 50% of all dividends from taxpaying French companies, such dividends being grossed up by the amount of the 50% credit. Effectively, the only dividends which are not entitled to the avoir fiscal are those representing surplus from foreign operations or pre 1965 surplus. Nevertheless, French corporations have the option to file a consolidated return including their foreign earnings and in this case the "avoir fiscal" includes surplus from foreign earnings.

The French avoir fiscal system thus does not require the complex determination of whether a particular surplus was earned in a particular period (except to the extent of pre 1965 surplus) or whether tax was, in fact, paid on income giving rise to such surplus, but relies only on the simple test whether the declaring company is a French taxpayer and excludes only two readily identifiable surplus items, namely foreign income in case of non-consolidation and pre 1965 surplus.

Our members submit that it would be unrealistic and dangerous for Canada to adopt a scheme of taxation which has failed conclusively and conspicuously in a highly developed country, such as the United Kingdom, after decades of experimentation and which had to be substantially modified to be accepted in the only other country which is currently using it. All the theoretical computations of the White Paper and the multiplicity of supporting documentation cannot override the simple fact that no other country in the world has been able to make a system, as complex as that proposed by the government, work effectively.

Mr. Arthur W. Gilmour, Senior Advisor to the Standing Senate Committee on Banking, Trade and Commerce has reached similar conclusions in his Special Study No. 4 on Grossing Up of Canadian Dividends, which is contained in Appendix "E" to the minutes of the March 4, 1970, proceedings of the above Committee. Mr. Gilmour's conclusions are based on the experience in the United Kingdom and other considerations. A copy of

Special Study No. 4 comprises Annex A of this brief.

When the White Paper grossing up procedure is applied to companies with foreign profits, such as the members of the IBC, the results become especially iniquitous, since only extremely limited credit is given for foreign taxes. Section 4.55 of the White Paper limits "credit to shareholders of Canadian corporations by reference to the Canadian corporate tax actually paid by their corporations". Therefore, foreign taxes paid by a Canadian company operating abroad or by its subsidiaries, even if fully creditable against Canadian corporate income tax of the corporation, will not flow through to recipient shareholders in Canada. Income taxation at shareholder level therefore effectively confiscates whatever benefit the foreign tax credit provisions may have given to the dividend paying Canadian parent company and, thereby, frustrates the Government's announced objectives in Sections 6.15 and 6.17 of the White Paper.

The above places Canadian corporations with domestic and foreign activities in a difficult position. If they receive dividends from foreign subsidiaries, the resulting addition to their earned surplus includes no distributable tax credits. This dilutes the tax credit which they would be able to pass on to their Canadian shareholders with respect to Canadian net income, thus making their dividends and shares less attractive in the market place. Canadian parent companies will, therefore, be reluctant to repatriate their foreign subsidiaries' earnings lest they dilute their Canadian shareholders' integration benefits. Placing obstacles in the way of repatriating foreign earnings would hurt our domestic economy and limit the flexibility of Canadian international companies.

In order to avoid this undesirable result, the Government should, if it insists on implementing its integration proposals, permit Canadian corporations to specify out which earnings a specific dividend is paid. Many Canadian corporations earn about half of their profits in Canada and the balance abroad. If, in accordance with usual practice, they distribute about 35% of annual earnings as dividends, they would be able to allocate the

entire distribution to domestic earnings. They would then be free to repatriate foreign earnings without diluting shareholders' tax credits.

Since Canadian companies with foreign operations as a rule also have a substantial percentage of foreign shareholders, the Government should, as long as integration benefits are limited to Canadian earnings and Canadian shareholders, also permit Canadian companies to allocate (a) their Canadian earnings (with attendant integration credits) to dividends paid to Canadian shareholders and (b) their foreign earnings (which do not qualify for such credits) to dividends paid to non- residents, who would not receive a credit anyhow.

Admittedly, availability of such elections would further complicate the proposed integration scheme. The inherent problem, however, lies in the scheme itself and in its proposed restrictions to domestic earnings and domestic shareholders. If the plan is to be enacted in this manner, and our members hope that it will not, it will necessarily require further and complicated modifications.

In any event, introduction of the Government's integration proposals place management in the difficult position where decisions on dividend distributions can no longer be based on corporate needs, but will depend on the tax effect of such distributions on their shareholders. After the top personal income tax rate is reduced to 50%, Canadian companies will be pressed to distribute their entire earnings on a current basis, either in cash or stock dividends, to reduce their shareholders' eventual capital gains tax liability. Since corporate earnings fluctuate, this will lead to wildly varying dividend patterns.

The above may be acceptable for purely Canadian held companies, since this may become the norm in Canada. Companies with foreign shareholders will however find such dividend patterns unacceptable. While dividend increases may be welcomed by many foreign shareholders, the unavoidable dividend reductions in low profit years will cause severe setbacks in international security markets. Stable, not fluctuating dividends are the international standard of conservative investments.

Foreign shareholders will also object to stock dividends because they attract Canadian withholding tax as well as income tax in the shareholders' countries of residence, without really increasing the value of the shareholders' investment or giving him the tax advantages which Canadian shareholders would enjoy.

Canadian companies with foreign shareholders thus face these problems:

a) Whatever dividend policy they adopt will be detrimental to a large portion of their shareholders and unacceptable in a large segment of their capital markets. Switching to a 100% distribution policy will hurt foreign shareholders and foreign securities markets, but it will help in the home market. Retaining more generally accepted distribution patterns will hurt their domestic shareholders and domestic capital markets. Eventually, securities in such companies may become the exclusive province of pension funds, foundations and other tax exempt institutions which can afford to consider solely the economics and not the tax effects of an investment.

b) Such companies will find it difficult to raise capital either at home or abroad, because their present dividend policies are not acceptable or because investors are concerned that such policies might change due to well known conflicting pressures.

The only manner in which this schizophrenic conflict of interests can be eliminated is to introduce a system by which Canadian corporations can make "deemed" distributions to domestic shareholders which carry a "deemed" tax credit with them. In the limited case of personal companies, the United States Internal Revenue Code now permits this option (Sec. 565). Our members

submit, however, that to introduce this additional complication to our Canadian integration system would complicate it so much further, that it would be easier to abandon the entire concept.

While the White Paper (Section 6.27 et seq) gives certain flow through privileges for foreign withholding tax, these privileges can never exceed 15/85th of the foreign net after tax earnings, whether or not the Canadian declaring company receives its foreign profits through dividends or branch operations. For example, if a Canadian closely held corporation has a wholly owned foreign subsidiary in a treaty country (the United States) which earns $2.00 and pays $1.00 of taxes (50% rate), this foreign subsidiary can distribute $1.00 as a dividend. The dividend will be subject to a 15% U.S. withholding tax, permitting the Canadian company to distribute 85 cents to its shareholders. A domestic Canadian shareholder in the 50% bracket will report $1.00 income on account of this dividend, compute a tax of 50 cents thereon and deduct 15 cents from the tax thereby incurring 35 cents effective dividend tax as compared to a tax zero had the same $2.00 been earned in Canada and subjected to 50% Canadian income tax in the case of closely-held corporation or against a tax of 10 cents if the declaring company had been a widely held Canadian corporation.

Strangely enough, although a Canadian shareholder suffers substantially if his company has foreign income, foreign shareholders of such Canadian company would not be hurt, since Section 6.28, 6.29 and 6.30 of the White Paper carefully protect the foreign shareholder while penalizing the domestic shareholder.

In the above instance, the Canadian shareholder is subject to heavier tax because his company earns foreign profits, even if there is no difference in the effective rate of corporate income tax on domestic and foreign earnings. Our members submit that this violates the premise in Section 6.8 of the White Paper that "the proposals are designed neither to provide an incentive to Canadians to invest abroad nor to place a barrier in the way of their doing so". Imposing substantial

additional tax on dividends received by corporate shareholders, depending on whether their company earns income here or abroad is not a proper example of non-discrimination. This is not only wrong in the opinion of our members, but, moreover, countervails the very policy stated in the White Paper on this subject matter.

Our members recommend that the present system of taxing domestic and foreign corporate distributions be retained. This system has served Canada and other nations well for many years. If specific features of our present system are thought to require reform, simple amendments can achieve this result. For instance, if in view of the proposed imposition of capital gains tax, it is necessary to increase the present tax credit percentage, or if, in order to benefit low tax rate shareholders, the present tax credit method is to be transformed to a tax refund approach, this can be readily accomplished by simple amendments within the framework of existing law.

2. Taxing Capital Gains of Substantial Foreign Shareholders on Disposition of Shares of Canadian Companies.

Our members urge that the proposal of Sections 6.46 and 6.47, last sentence, taxing capital gains of substantial non-resident shareholders, be eliminated. They submit that the proposed tax will be unworkable, unfair and offensive to the international investing community at large as well as damaging to Canada's economic development.

Taxing capital gains of non-resident shareholders under any circumstances is inconsistent with long standing international principles and practices. Neither the United States nor the United Kingdom impose such a tax. The OECD Model Treaty (accepted by Canada with only minor reservations not pertinent to this subject matter) does not permit such a tax, and, generally, such tax would be uncollectible in most instances. Canada has, (except for an old treaty with Germany, which is discussed below) consistently refused to agree to such tax when foreign countries have attempted to impose it on Canadian shareholders.

Of all major industrial countries, only Germany and Holland now impose capital gains tax on substantial foreign shareholders. Germany has waived imposition of this tax in practically all foreign tax treaties, excepting, however, its tax treaty with Canada which is quite old. Since Germany has also accepted the OECD model treaty, we understand that, based on reciprocity, Germany would waive capital gains tax on substantial Canadian shareholders when its treaty with Canada is renegotiated. Holland introduced its similar tax under the influence of German occupation during World War II. This tax has been waived in most Dutch tax treaties, except when applicable to former residents of Holland. In its internal legislation, Holland has, since the end of World War II, substantially modified and relaxed the imposition of capital gains tax on foreign shareholders, thus completely exempting corporate shareholders and raising the percentage for substantial holdings from 25% to 33-1/3%.

If Canada now subjects foreign shareholders to capital gains tax, this will result in double taxation, either because of the unusual nature of the tax which contravenes international practices, or because, due to differences in roll-over treatment and other tax procedures, Canadian tax may be incurred at different times than the corresponding foreign tax or because the foreign jurisdiction may satisfy its tax needs by other means of taxation.

Capital gains tax on substantial foreign shareholders will typically affect a type of foreign investment which involves the greatest benefit to our economy, namely seed money invested by foreign risk takers in new businesses or ventures, which usually is accompanied by special knowhow, technologies, and marketing opportunities, which are not available locally. Loss of this special and rare type of foreign investment would substantially retard the development of our national resources and economy. One dollar of seed capital provided in this manner has greater impact on our economy than a multiple in portfolio investments.

The impact of this provision of the White Paper is grave in the opinion of our members. Capital is scarcer today than ever. As a result, it can be choosy, selecting for investment only those economies which provide the most favorable tax and investment climate.

In a world economy competing for capital investment no one country can afford to fly in the face of accepted international practices. In the case of Canada, which is so intimately linked with the economy of the United States which does not impose capital gains tax on foreign investors, the disparity with the United States tends to concentrate available new investment in the United States and away from Canada.

Another objection to taxing capital gains of substantial foreign shareholders is that the tax will affect foreign shareholders differently and more severely than domestic shareholders.

i) Domestic shareholders' capital gains tax on sale of stock can be effectively mitigated by current earnings distributions with attendant tax credits. By contrast, foreign shareholders are specifically denied tax credits on dividend distributions. In fact, they must pay Canadian withholding tax and foreign income tax on Canadian distributions. It seems especially unfair to deny integration benefits to shareholders who are to suffer Canadian capital gains tax on disposal of their Canadian shares.

ii) Foreign shareholders are treated as if they were Canadian residents for purposes of the five-year revaluation tax, but otherwise they are treated as non-residents, unable to take advantage of benefits which might flow to them if they were residents. A foreign shareholder may have losses on actual or deemed dispositions of other securities in Canada or abroad, or he may have incurred property taxes, interest and other charges in connection with his investments in Canadian shares. Such losses or costs may well reduce or eliminate nominal gains on Canadian securities, but

the White Paper appears to exclude such offset or deduction. Also, while the Government would tax a substantial non-resident shareholder's gains on disposition of Canadian shares, there would be no offsetting Canadian benefit if such disposition results in a loss.

The above differences are neither fair nor equitable. They smack of a "heads I win, tails you lose" philosophy, which does not seem appropriate for Canada to adopt.

Imposition of capital gains tax on substantial foreign shareholders seems especially inappropriate in the case of Canadian companies, which, like our members, derive a major part of their profits from non-Canadian operations. In such cases, Canada would frequently tax appreciation resulting principally or exclusively from non-Canadian operations and realized in sales from one non-resident to another. If substantial non-resident shareholders in Canadian multi-national corporations realize that they will eventually suffer Canadian capital gains on the appreciation resulting from their companies' worldwide activities, they may well press for removal of the parent company to another jurisdiction not imposing such tax. This would be easy to accomplish since, as shown above, such tax is imposed by only one or two other countries. As a result, Canada may lose a number of important multi-national companies which are now headquartered here.

Regardless of the merit of capital gains tax on foreign shareholders in general, fairness and expediency seems to require that Canada limit this tax at least to the gains produced through Canadian operations. Allocation may be difficult, but could probably be based on the increase in earnings per share in Canada and abroad. Such limitation of foreign shareholders' capital gains exposure would reduce shareholder pressure to relocate Canadian parent companies of multi-national businesses.

We must expect that, if substantial foreign shareholders of Canadian corporations know that Canada will tax them on disposal of their shares, even if sold to another non-resident, they will attempt to avoid this tax through use of bearer shares, unrecorded transfers, nominee holdings, understated sales prices and other easily available means. Canada will find it

difficult to control such actions in foreign countries, especially since there is little sympathy in international community for such a tax in the first place (see above). We therefore expect that this tax will produce little worthwhile revenue and that its yield will be entirely out of proportion when compared to its many drawbacks.

Effective enforcement of this tax on non-residents would require such restrictions on holding and disposition of foreign held shares in Canadian companies as to make them virtually unmarketable or marketable only under circumstances which would prevent their sale on recognized securities exchanges in the ordinary course of business. For instance, Canadian companies issuing their shares on European securities markets must conform to European practices and the listing requirements of European stock exchanges by issuing securities in the bearer form, which is usual there. If future restrictions should make this impossible, there may be a wholesale delisting of Canadian securities on European stock exchanges and public Canadian companies will be effectively barred from foreign capital markets.

In view of the above considerations, our members recommend that Sections 6.43 to 6.47 of the White Paper be eliminated and the present general international rule of law be retained that the profits of non-residents on disposition of shares of Canadian companies, or for that matter other property in Canada, other than business assets or real estate, be excluded from Canadian capital gains tax. Our members are aware of the "loophole" argument of Sections 6.44 and 6.45. As noted previously in this brief, they feel that other methods can effectively close such tax avoidance loopholes without, at the same time, imposing onerous and unworkable restrictions on proper business transactions.

3. The Five Year Revaluation Rule

The proposal to tax unrealized gains on shares of widely held Canadian corporations on a five year revaluation basis, as set forth in Sections 3.36 to 3.38, is easily the most controversial of the various White Paper proposals. The proposal deviates from accepted tax practices in virtually all major countries and has drawn numerous attacks from Canadian tax payers and experts. There are indications that the Government

may abandon or substantially modify the proposed five year tax on unrealized gains.

Since so many valid and weighty arguments have been advanced by others as to the general undesirability of the five year tax on unrealized capital gains, this brief will limit itself to listing specific problems which the five year revaluation rule would create if applied to substantial foreign shareholders of widely held Canadian corporations.

All the problems are in addition to the principal problems flowing from imposition of Canadian capital tax on foreign shareholders. These problems have been listed in detail under the previous heading and would apply with even greater force if the five year revaluation tax were extended to foreign shareholders.

a) Since other countries tax capital gains on realization, rather than based on periodic theoretical revaluations, there is often no foreign tax from which Canadian tax on deemed realization of gains may be deducted. If capital gains tax is subsequently incurred by the foreign shareholder in his country of residence when he sells the shares in question, he may not be able to deduct prior years' Canadian revaluation tax, especially if considerable time has passed, or such foreign tax may be offset by other losses and deductions. As a result, double taxation may be a frequent occurrence.

b) The five year revaluation tax assumes that the shares subject to revaluation are readily marketable, so that the affected shareholders can freely sell them at any time to raise the funds required to pay the tax. This is frequently not the case with non-resident shareholders:

   i) Since by definition, the tax applies only to holders of 25% or more of a Canadian company's shares it would be only under the rarest circumstances that such large holdings can be sold through normal market facilities at quoted trading prices. Special underwritings

would be required. During bear markets, disposal may be completely impossible. If the Canadian market is too limited to accept so much additional stock, foreign purchasers must be found. In view of the special disadvantages which foreign shareholders will suffer if the White Paper proposals are implemented, foreigners are likely to pay less than Canadian quoted trading prices, thus reducing realizable value.

ii) Foreign shareholders who live in countries where capital gains taxes have applied for a number of years, may have a very low basis for their Canadian shares and would thus have to pay heavy foreign capital gains tax on disposal of their Canadian holdings. In such case, the shares are not freely saleable and the gross sales price would be considerably below the shareholders' actual proceeds.

iii) Foreign currency restrictions, provisions of foreign trusts and foreign legal rules may complicate or forbid disposal.

Quoted Canadian market value thus does not present a fair basis for applying a five-year revaluation tax to non-resident substantial shareholders.

c) If the five-year revaluation tax on substantial foreign shareholders is enacted, it will make conclusion of foreign tax treaties virtually impossible, unless Canada is prepared to waive the rule in each instance. This will significantly impede and delay the Government's announced goal to establish a far-ranging network of mutually advantageous tax conventions.

On the other hand, if the Government will widely waive the revaluation tax in treaties, it will be virtually a dead letter, at least as far as new investments are concerned, since foreign investors will take care to route future substantial investments in Canadian industry through affiliates or conduits in treaty countries exclusively.

d) Imposition of five-year revaluation tax will discourage foreign owned closely held Canadian corporations from offering shares to Canadians and would penalize those foreign shareholders which in the past responded to Canadian Government policy by publicly selling shares in Canadian subsidiaries to create a degree of Canadian ownership.

Foreign corporations which as a result of public offerings to Canadian shareholders, now hold shares in a widely held Canadian corporation will be tempted not to let such corporation participate in its new technical developments and knowhow, lest the resulting increase in the recipient company's value increase the foreign parent's five-year revaluation tax. In such cases the parent may be tempted to establish a closely held new subsidiary to exploit new technical developments and knowhow in the Canadian market.

The above list of specific difficulties under the five-year revaluation tax, if applied to substantial foreign shareholders of Canadian companies, has been purposefully kept brief because the IBC hopes that, by the time it can make an oral presentation of its position, the Government will have formally withdrawn this proposal. In the event, that this will then not be the case, the IBC request permission to make a supplemental presentation on this point.

In view of the possibility that the five-year revaluation tax on shares in widely held Canadian corporations may be replaced by revaluation tax at the time of the shareholder's death, our members want to address some final comments to this alternative. If applied to substantial foreign shareholders, this tax would suffer all the disadvantages and objections set forth above. There would be the additional complication that shareholders which can incorporate their holdings can escape the tax while those unable to do so would eventually bear its full brunt. Since corporate holdings would be effectively exempt, revaluation tax collections from foreigners will probably be minute. Under these circumstances, it would be much better to limit revaluation tax to residents, since the disadvantages of extending the tax to non-residents would far outweigh the advantages.

ASSOCIATION OF INTERNATIONAL BUSINESS CORPORATIONS

Annex A to Brief on White Paper Proposals

Standing Senate Committee

APPENDIX "E"

SPECIAL STUDY NO. 4

GROSSING-UP OF CANADIAN DIVIDENDS

INTRODUCTION

One of the major proposals of the authors of the White Paper is set out in the following paragraphs thereof:

1.39 The government proposes to alter the method of taxing corporations by establishing a single rate of corporation tax and providing a system of credits to shareholders for corporate taxes paid. An important distinction would be made between private, closely-held corporations and public, widely-held corporations.

1.40 For closely-held corporations, which are usually smaller businesses managed by the shareholders, the tax should be related as closely as possible to rates paid by individual shareholders. There is usually a close identity between the shareholders and the corporation. These corporations usually compete in markets with unincorporated businesses subject only to personal income tax. Under the proposed plan the federal income tax paid by such corporations would be treated as a prepayment of the personal income tax on behalf of individual resident shareholders. Under certain conditions the corporation could elect to be taxed as a partnership of its shareholders. In other cases the shareholders would pay tax on a sum that includes their dividends plus a related amount of corporate tax already paid; and they would then claim credit for the corporate tax paid, and qualify for a refund if their own rates are lower than the corporate rate.

1.42 Widely-held corporations are usually larger businesses where the link between shareholders and management is tenuous. Such corporations are themselves important economic entities. Their products or services are usually sold in competition with other large corporations, where prices yield an adequate return after paying corporate tax. One half the corporate income tax paid by such corporations would be regarded as a prepayment of individual tax for individual Canadian resident shareholders, but the other half would not be linked in this way. Shareholders receiving dividends from profits taxed under the new plan would be liable for tax on the dividend plus an amount of "creditable tax" equal to half the dividend and would be given credit for that amount of tax. This system would be roughly equivalent to the present dividend tax credit for taxpayers in the 50-per-cent tax bracket and would be more favorable for those in lower tax brackets. It would thus provide a powerful incentive for investment by Canadians in Canadian corporations.

To implement the proposal outlined in Paragraph 1.39 above, the authors of the White Paper deem it necessary to eliminate the lower rate of taxes allowed on the first $35,000 of taxable income, to confiscate by way of income tax any subsidies paid to encourage scientific research and the like, remove tax incentives allowed to the extractive industries and new industries in designated areas, and levy Canadian taxes on the earnings of foreign subsidiaries of Canadian companies.

The justification of this seemingly ruthless sweeping away of existing benefits to encourage industry is to grant tax credits to Canadian shareholders who may receive dividends from Canadian companies within a period of two and one-half years after the year in which the income is earned by the corporation.

The tax-credit to be permitted Canadian shareholders will be computed in accordance with the following formula:

	Closely-held Corporations Federal	Closely-held Corporations Provincial	Widely-held Corporations Federal	Widely-held Corporations Provincial
Canadian dividend received	100		100	
Amount to be added to dividend received to achieve "grossing-up"	100		50	
Amount of dividend to be included with other income of individual shareholders	200		150	
Tax on total income at increased rates proposed in White Paper	xx	28% of federal tax	xx	28% of federal tax
Less deduction from tax payable on total income	80% of dividend received of 100	20% of dividend received of 100	40% of dividend received of 100	10% of dividend received of 100
Net tax payable	xx	xx	xx	xx

The system of grossing-up dividends proposed for Canada by the authors of the White Paper was first introduced in Great Britain in the mid-1800's at a time when the principles of taxation were being develop on a trial and error basis.

This system has in more recent years been progressively abandoned by Great Britain as failing to meet day demands of governments.

The grossing-up system was finally abandoned by Great Britain in 1965. An extract from the Budget Statement of the Chancellor of the Exchequer of April 6, 1965, may be of interest to members of the Standing Committee. It follows, with underlining inserted by your advisor:

> "Our present method of taxing corporate bodies goes back to the days before the joint stock company, as we know it, existed, when the few companies that did exist were thought of as being in the nature of large partnerships. At that stage, income tax was virtually a flat-rate tax: it applied to the income of companies and individuals alike; and when a company distributed its income to its shareholders in the form of a dividend, a second lot of tax was not exacted. Since those days, there have been extensive changes both in the tax system and in the status and position of companies.
>
> First, the personal income tax has become a graduated tax, differentiated according to the circumstances of each taxpayer, and made progressive by reduced rate relief at the lower end of the scale, and surtax at the upper end. Secondly, company taxation has been altered by the introduction of profits tax, which is imposed on the whole profits of a company, whether or not distributed, and is not repayable to shareholders. *These changes have made obsolete the idea that companies and individuals should be treated for tax in the same way. By separating formally the two taxes, namely, the tax on corporations and the tax in individuals, we shall be bringing the tax system of the United Kingdom into line with reality and adopting what has become the general practice throughout the world.*
>
> Hitherto, any idea of reforming the tax system by introducing a corporation tax in this country has foundered because of the widely held view that to levy a separate tax on company profits which is distinct from and additional to, the income tax levied on individuals would constitute 'double taxation' of company profits. The profits tax already contradicts this argument. *The truth is that only part of a corporation's income is distributed to the shareholders in the form of dividends; the rest is not part of personal income and cannot be treated*

as such. The majority of the Royal Commission on Taxation came near to this view when it said:

> *'We accept the necessity for the subjecting company profits to a special tax regime that is something more than a mere attempt to collect personal income tax in advance.'*

But it baulked at the logical conclusion, which is that there should be a separate tax on the profits of corporations quite distinct from the income tax that is levied on distributed profits.

There then remains the questions of how to frame the tax on company profits. *As soon as it is divorced from the taxation of individuals, we are free to draw it up on principles most conducive to economic growth and efficiency.* The two ways open to us of raising the same amount of revenue from corporations are, either to confine the tax to undistributed profits and levy it at a relatively high rate; or, alternatively, to impose a tax on the whole profits, irrespective of distributions, at a much lower rate.

The latter tax, in my view, has a much greater economic and incentive value than the former. A tax confined to undistributed profits penalises investment and growth; it severely handicaps the young and dynamic companies which may rely on ploughed-back profits for expansion. A tax on the whole profit has the opposite effect. It makes it possible to shift the burden of taxation in such a way as to relieve the faster-growing companies, which are generally low distributors, and thus enable them to expand even faster. It will place more of the burden on those companies which are high distributors. *It gives a strong incentive to all companies to plough back more of their profits for expansion.* Finally, the incentives to cut costs and to raise efficiency through new investment are much stronger, and must be much stronger when a lower percentage of additional profits is taken in taxation than under the present system where 56¼ per cent of any additional profit would go to tax.

The present system is also unnecessarily complicated because of the existence of two taxes—income tax and profits tax—levied broadly on the same income but according to different rules. It is a patchwork system and it is not standing up to the strains that result from the efforts of Governments to use the tax system for economic purposes. *The result has been the growth of abuses and anomalies, such as recovery by companies or individuals of large sums from the Revenue by way of repayment of tax, although no corresponding sum has ever reached the Exchequer".*

(Simn's Income Tax—Vol 2A—Page 404)

It may be that the portions in italic of the above statement have a meaning equally applicable to Canada.

Members of the Committee will be hearing briefs on the proposal to gross-up Canadian dividends. They will have to consider whether Canada, if it abandons its long-established system of taxing corporations in favour of a system recently abandoned by the country that introduced it, may be exposing Canadian business to those risks referred to by the Chancellor of the Exchequer of Great Britain on April 6, 1965.

APPENDIX "D"

STATEMENT OF MORTIMER M. CAPLIN
BEFORE THE STANDING COMMITTEE ON BANKING, TRADE AND COMMERCE
OF THE SENATE OF CANADA
ON INTERNATIONAL ASPECTS OF WHITE PAPER TAX PROPOSALS

June 3, 1970

My name is Mortimer M. Caplin, and I am a member of the Washington, D. C. law firm of Caplin & Drysdale. I served as Commissioner of Internal Revenue of the United States from 1961 to 1964 and have resumed the practice of law since that time. Before becoming Commissioner, I was a Professor of Law at the University of Virginia, specializing in tax and corporation law.

I am accompanied today by my partner, Stanford G. Ross, who was formerly Assistant Tax Legislative Counsel of the United States Treasury Department where he was one of the principal draftsmen of the foreign income provisions of the Revenue Act of 1962. Mr. Ross later served as a White House staff assistant on economic matters to President Johnson. He is presently Chairman of the Subcommittee on Subpart F of the Committee on Foreign Tax Problems of the American Bar Association Section of Taxation.

I am greatly honored to appear before you today. I do so at the request of the Association of International

Business Corporations to provide testimony on recent United States experience with international tax matters, particularly with respect to the controlled foreign corporation legislation enacted in the Revenue Act of 1962, often known as "Subpart F."

I will attempt to make clear in my testimony what the United States experience has been from the standpoint of both the tax administrator and the businesses which have had to accommodate to the new laws. Also, as a long standing observer of the tax law with a predilection for tax reform, I will try to go outside those viewpoints and present the kind of overall perspective which might be helpful to you as legislators.

For over 20 years I have written, lectured and testified in favor of tax reform in the United States. In this connection, I recently testified before the House Ways and Means Committee in favor of various reform proposals, such as the minimum tax, which were ultimately enacted in our own Tax Reform Act of 1969.

Let me make clear that I am not here to be an advocate for or against the reform proposals suggested by the Canadian

Government in the White Paper. It would be presumptuous for me, as a foreign guest, to attempt to pass judgment on what is or is not appropriate tax policy for Canada. My goal here today is only to place in proper perspective for you the United States experience. You will, of course, draw your own conclusions as to the extent to which this experience is relevant to the decisions that you are making on appropriate tax policy for Canada.

BACKGROUND OF U. S. SUBPART F

I shall begin by describing the way in which the Subpart F legislation was developed in the United States, as I believe this will shed light on the basic balance of payments considerations toward which the legislation was directed. As you are aware, the United States for almost 15 years has had persistent problems with its balance of payments position. These problems have caused every Administration in the United States, beginning with that of President Eisenhower, to analyze the effect on the balance of payments of its rules for taxing foreign income. This analysis has led in the past decade to a great deal of experimentation in the use of the tax law as an instrument of foreign economic policy.

Subpart F, which was enacted in the Revenue Act of 1962, thus stands as the first of a series of measures adopted by the United States. It had its origin in a 1960 report prepared by a Task Force headed by then Professor Walter Heller, later to become Chairman of the Council of Economic Advisors, to President Kennedy to study the American balance of payments and foreign economic policy. The Heller Task Force recommended the elimination of tax deferral by the United States for foreign corporations controlled by Americans, so as to remove any incentive in the tax laws for overseas investment and thus improve the balance of payments.

After taking office, President Kennedy made tax reform one of his first and principal legislative objectives. In April, 1961, he proposed to the Congress a series of reforms, including a recommendation that deferral of taxation on foreign income be eliminated for operations located in developed countries or in tax havens. The Administration argued that deferral may have been justifiable during the period in which Western Europe was recovering from the war and United States investment could make a contribution to this end. However, by 1961 Western Europe had recovered and the U. S. balance of payments position was a source of growing concern. The Administration believed that by taxing the

income of American-owned foreign corporations on a current basis, it would eliminate any tax incentive to investment in such countries. It hoped that, since they would be subject to United States tax in any event, foreign earnings would be remitted to the United States to the benefit of the balance of payments.

Taxpayers vehemently opposed the Kennedy Administration's proposal. They argued that overseas investment was undertaken because it presented the possibility of profitable investment and was not undertaken to avoid taxes. They further pointed out that, in the long run, successful United States investment abroad was a valuable aid to the balance of payments, since eventually foreign earnings did come back to the United States.

After almost a year of consideration, the House of Representatives in March, 1962 enacted provisions patterned on the Administration's original proposals but with the modification that deferral would be permitted where the earnings were reinvested in the same trade or business.

When the House Bill went over to the Senate for consideration, taxpayers renewed their opposition, arguing that the

"same trade or business" test would be unworkable and that the tax provisions would have a detrimental effect on the competitive position of United States overseas businesses. The Treasury Department, though supporting the House Bill, sought to eliminate the "same trade or business" exception and to tax all foreign profits except those from less developed countries.

Faced with the Treasury supported House Bill on the one hand and strong taxpayer opposition to the elimination of deferral on the other, the Senate Finance Committee adopted the Subpart F provisions as a compromise measure. It reflected an attempt to support to some extent the Treasury's economic goals while accommodating to the realities stressed by overseas businesses. The Senate Finance bill was subsequently accepted by both Houses of Congress and Subpart F was signed into law by President Kennedy.

CONTENT OF U. S. SUBPART F

As enacted, Subpart F generally taxes the undistributed base company income of a controlled foreign corporation as a constructive dividend to the United States shareholder. Controlled foreign corporations are those owned more than 50 percent by Americans. Base company income includes passive holding company-type income such as dividends or interest as well as sales or service income diverted from a related party to a low-tax jurisdiction.

Under prior law, no U.S. tax was imposed on earnings of foreign subsidiaries until they were remitted as dividends to

the U.S. parent company. Upon receipt by the parent company, the dividends were subject to U.S. taxes at the same rate as profits from domestic operations, with a credit for the foreign taxes paid with respect to the dividends. Simply stated, Subpart F imposes a current tax on specified earnings of foreign subsidiaries to close the gap between relatively high U.S. taxes and low foreign taxes. The legislation seeks to eliminate in some situations any tax advantage in holding profits abroad in foreign subsidiaries as opposed to remitting them to the U.S.parent company.

The accommodation of the competing views of the Government and the business community was accomplished largely by means of the so-called minimum distribution provision. This provision eliminates from Subpart F coverage those foreign subsidiaries of domestic corporations which pay high foreign taxes, or make substantial current dividend distributions, or through some combination of such factors, receive little actual benefit from deferral of United States tax.

Most international business is undertaken by large and substantial corporations. These corporations often have operations in many jurisdictions, and are more properly thought of as multi-national corporations than as nationals of a single jurisdiction. In the United States, these multi-national corporations almost invariably elect to be treated under the minimum distributions provision of Subpart F. This provision permits them to be treated on an overall or composite basis. As a result of being able to

average out effective tax rates in high and low tax countries, they can -- and do -- maintain the benefits of their tax haven subsidiaries.

No minimum distribution is required where effective levels of foreign taxes are within 90 percent of the U.S. rate. Foreign taxes, as you are aware, generally approximate or exceed the current U.S. corporate tax rate of 48 percent. Through this minimum distribution concept, the United States accepts the fact that multi-national corporations will organize their affairs to reduce taxes in any way which is customary and accepted by the host countries.

It would be a mistake to conceive of minimum distributions as a relief provision, as an exception to Subpart F. It is in practice the heart of Subpart F and establishes the tax regime for most American overseas operations. It is clear that no foreign income provisions could have been enacted in the United States that did not, through the minimum distributions concept, provide these multi-national corporations with the flexibility to maintain their competitive position.

PRINCIPAL PURPOSE OF U. S. SUBPART F

I have elaborated on the balance of payments background of Subpart F partly because of the emphasis your Government's White Paper makes in describing Subpart F as U. S. legislation to counter tax haven abuse. It was not primarily conceived of for this purpose. I think it is fair to say

that it would not have been proposed or enacted if its principal purpose were to counter tax abuse.

Our Internal Revenue Code, like your tax law, contains a number of traditional tax avoidance provisions such as the requirement for arm's-length dealings between related parties; the Government's power to reallocate income or deductions among related parties to clearly reflect income; disregard of sham corporations or artificial arrangements, and several others. These provisions, fully and properly implemented by tax administrators, can be an adequate arsenal of defense against tax abuse in the international area.

That the primary thrust of Subpart F is in the area of balance of payments rather than tax abuse can, I think, be demonstrated by examining its treatment of intermediate sales and service companies. Such companies have been set up in tax haven countries to siphon off income from related manufacturing or distribution companies. Thus, the Swiss subsidiary of a U. S. company may be used to sell goods produced by a related corporation in France to another related corporation in Germany. Assuming that France and

Germany will allow latitude in inter-company pricing, the Swiss subsidiary may divert a considerable portion of the profit to itself in order to avoid higher French and German taxes. The "abuse" -- if there is one in this situation -- is at the expense of Germany and France, not the United States.

During the consideration of Subpart F, many taxpayers complained that the United States should not concern itself with avoidance of foreign taxes. Indeed, if the purpose of the legislation were to counter tax abuses, this argument would have carried great weight. But the position of the Treasury was that the question was not one of tax avoidance but rather of tax incentives for foreign investment. In eliminating such incentives, the important question was not to whom the taxes were paid, but rather the overall effective level of taxation imposed on the venture. In other words, the United States did not act -- as some have charged -- in an attempt to set standards of international tax morality, but merely to further its own balance of payments objectives.

SUBPART F DIRECTED AT TAX ABUSES PECULIAR TO U.S. LAW

I do not mean to suggest that Subpart F is unconcerned with tax haven abuses. But I think it is useful for you to

consider the extent to which the abuses at which Subpart F is directed, and the problems which they reflect, are peculiar to U. S. tax law.

Thus, a principal target of Subpart F was the use by American companies of holding companies in tax haven countries to hold the stock of operating subsidiaries. The reason this practice was seen as an abuse is that under U. S. tax law dividends from foreign corporations are taxable to the U. S. recipient. By using tax haven holding companies, U. S. taxes could be deferred or avoided on dividend distributions, with the cash being shifted free of U. S. tax to other foreign subsidiaries.

As I read your Government's White Paper, however, it does not propose to tax dividend distributions to Canada from operating subsidiaries in treaty countries. This would seem to eliminate the need to be concerned about so-called tax haven holding companies for such subsidiaries. It would not seem appropriate to describe as an "abuse" the use of a holding company to receive the operating subsidiary's dividends if Canada would not tax the dividends in any event.

Your Government's White Paper indicates that it intends to use Subpart F-type provisions to avoid diversion of passive-type taxable income from Canada. This has also been a matter of concern to the United States. For example, a domestic corporation might seek to transfer an income producing asset such as a patent to a tax haven subsidiary to permit tax-free accumulation of royalty income. While Subpart F may discourage such diversions, it would not be accurate to say that it is the principal weapon in the Government's arsenal for this purpose.

Under United States law, transfers of property such as patents to controlled corporations may be made without tax. This is roughly equivalent to what the White Paper refers to as roll-overs. Where the controlled corporation is foreign, the United States law requires that an advance ruling be obtained from the Commissioner of Internal Revenue that the transaction does not have as one of its principal purposes the avoidance of United States income tax. If the ruling is not obtained, the transfer becomesa taxable event. The guidelines issued under this provision indicate quite explicitly that transfers of income producing property such as patents to foreign subsidiaries for licensing (as opposed

to productive use) are likely to fall afoul of the Government's standards. The transfer of the patent, therefore, would give rise to an immediate tax, measured, in effect, by the present value of the income that is to be diverted. The White Paper, as I understand it, would go further than U. S. law by taxing all transfers of property to controlled,foreign corporations. Under these circumstances, the concern expressed in the White Paper as to diversion of income is difficult to understand.

Before leaving my description of the content of Subpart F, I would like to emphasize:

First, the purposes and provisions of Subpart F go far beyond the objective of correcting tax abuses and, indeed, relate primarily to balance of payments considerations. I shall discuss in a moment some of the changes in our balance of payments thinking since 1962, but the question on which I think you will want to focus is whether Subpart F does not go beyond your actual purposes;

Second, to the extent Subpart F is concerned with correcting abuses, it is relevant to inquire whether the abuses are peculiar to the legal context in which the legislation took shape, that is, U. S. tax law. There is, I think,

some danger that Subpart F may provide you with a cure for which, in Canada, there is no disease; and

Third, it is also relevant to inquire whether as an instrument for correcting such abuses as are common to our respective tax systems, Subpart F is as effective as other instruments available in your law or which you might choose to adopt.

U. S. EXPERIENCE SINCE ADOPTION OF SUBPART F

I would now like to review for you some of the experience we have had in the United States since enactment of Subpart F and discuss the trend of our thinking, first, on the balance of payments problem and, secondly, on the control of tax abuses.

The Revenue Act of 1962 was only the first of a series of tax and related measures intended to improve the United States balance of payments position. It was followed in 1963 by the Interest Equalization Tax, an excise tax imposed to

inhibit the purchase of foreign securities as portfolio investments by U. S. citizens.

A critical underlying premise of the tax changes in 1962 and 1963 was that the United States would never resort to direct controls over foreign investment. Treasury Secretary Douglas Dillon made it clear that the United States interest in a free flow of international trade and investment was a paramount policy. It seemed to follow that the tax laws would have to be the principal instrument for any restrictions on overseas direct investment.

As time went on, it became apparent that the 1962 tax changes had little impact on overseas investment and the balance of payments, and the Government reluctantly turned to more direct measures. In 1965, the Commerce Department initiated a voluntary direct investment program to influence American businesses to exercise restraint in their overseas investment activity. This program was made mandatory in 1968 by the issuance of Foreign Direct Investment Regulations carrying criminal sanctions where direct investors exceed the allowable limits authorized by the Regulations.

While the United States was obliged to move from indirect to direct restrictions on foreign investment, it found that

other tax measures could be used effectively to improve the balance of payments by improving the tax treatment of foreign investors in the United States.

In his Balance of Payments Message of July 18, 1963, President Kennedy announced the appointment of a Task Force to consider the problems of the foreign investor. The report of this Task Force, headed by Henry Fowler who was to become Secretary of the Treasury, led to a set of proposals by President Johnson in 1965 that were enacted in the Foreign Investors Tax Act of 1966. The provisions here were basically designed to facilitate investment in the United States by foreign persons. Under the new law, the United States generally allows tax-free investment in United States securities or real estate. One of the consequences has been a contribution to the rapid development of off-shore mutual funds channelling European dollars into United States investments. Undoubtedly, the United States balance of payments has been helped by the increased flow of foreign investment that has taken place.

With the election of President Nixon, a new team has taken its place in the Treasury Department. This new team has undertaken to review our rules governing taxation of

foreign income, and we are now beginning to see the results of their evaluation of the developments during the Kennedy-Johnson Administrations. The major proposal to emerge from the new Administration is for a Domestic International Sales Corporation (DISC).

The DISC proposal is a move toward an incentive system for improving the balance of payments through increased exports. Under the proposal, U. S. corporations engaged in exporting would be accorded deferral of U. S. income taxes. The proposal also provides DISC corporations with great flexibility on the investment of their assets and the conduct of their activities.

The philosophy behind the DISC proposal is perhaps relevant to your deliberations here in Canada. The studies recently undertaken by our Treasury have concluded that deferral of taxation of foreign earnings is basically a sound approach. They feel that any attempt to impose additional taxes on United States companies operating abroad would be self-defeating and would prejudice the position of United States businesses in world markets. The Treasury has also indicated that it is examining the advisibility of an exemption system for foreign

earnings. At any rate, they strongly believe that a more favorable system should be created for export earnings by creating this new class of domestic corporations known as DISCs.

It is not yet clear what the Treasury intends to do with Subpart F. Although some minor changes affecting foreign income were made in the 1969 Tax Reform Act, including one in Subpart F, at the request of the Treasury, Congress put off consideration of basic changes pending further study. There are clearly parts of Subpart F on which there is unanimous agreement that corrective change is necessary and on which proposals for change will not generate any significant controversy. On the other hand, other problems in the direct investment area have now superseded Subpart F. Elimination or greater liberalization of the foreign direct investment program is the first item on the agenda in this area, although such a step must undoubtedly await improvement in our balance of payments position.

The ultimate conclusions from this process of experimentation have yet to be drawn. My personal view is that the Foreign Investors Tax Act of 1966, in which considerations of tax reform and economic policy converged,was a constructive

achievement. In contrast, Subpart F has fallen far short of the attainment of its objectives.

If I were to speculate about the longer-term future, I would start by observing that there is a general feeling that with tax rates rising all over the world, the problems of double taxation and over-lapping national jurisdictions to tax are matters of the most serious concern. Overseas business makes a substantial contribution to economic growth and stability on a national and international basis and must be dealt with equitably. The activities of multi-national corporations must be facilitated consistent with their bearing normal tax burdens in countries where they derive income. Hopefully, our overall economic position in the United States will be righted to the point where we can design fair and effective tax laws without the burden of making them do economic jobs for which they are ill suited.

In the area of curbing tax abuses, one of the principal developments in the U. S. in recent years has been the issuance of extensive regulations under Section 482 dealing with allocation of income among related parties. Despite the enactment of Subpart F, the United States over the past eight

years since passage of the Revenue Act of 1962, has undertaken a vigorous and active program to properly implement the traditional administrator's tools to deal with tax abuse. To complement the new regulations, the Internal Revenue Service has undertaken to develop skilled personnel and audit techniques to administer more effectively in these areas. These regulations and extra administrative effort have gone a long way toward insuring greater taxpayer compliance and in strengthening the hand of the Treasury in dealing with abuse situations. There are indications that the present concern of the Treasury in this area is toward developing less burdensome methods of administering the standards.

I have already referred to the guidelines adopted by the Treasury with respect to tax-free roll-overs involving foreign corporations. Here also the Treasury is considering ways to be less restrictive. Despite a very major administrative effort to provide guidelines and to act more even-handedly, it is generally agreed that our rules are out of step with the needs of international business to reorganize their activities. New legislation is expected which will provide foreign corporations greater flexibility and ease

to plan their affairs. I note that the White Paper, in sharp contrast, proposes a general prohibition on roll-overs involving foreign corporations.

ADMINISTRATIVE COMPLEXITY UNDER U. S. SUBPART F

As to the administrative problems of Subpart F, there is unchallenged agreement in the United States that Subpart F is among the most complicated provisions of our tax law, if not the most complicated. It has been described as "a lofty plateau of complexity that the Internal Revenue Code had previously attained only in occasional subsections." Not only has it coined a myriad of highly technical concepts of its own, but it draws upon various concepts of other parts of the Internal Revenue Code which, when applied in this area, take on unusual implications.

We have been forced to confront such new concepts as "United States shareholders," "controlled foreign corporations," "foreign base company income," "foreign base company sales income," "investment in United States property," "minimum distribution," "minimum overall tax burden" and so forth. Further, the earnings of a foreign corporation must be calculated in a way which imposes enormous demands for detailed records that would otherwise not be necessary.

When a change was made for domestic tax purposes in the Tax Reform Act of 1969 with respect to the problem of the proper allowance for depreciation in computing corporate earnings and profits, its unforeseen application in the foreign area caused the Senate Finance Committee to make a special exception which would leave that area alone pending further study. The problems of applying domestic concepts such as depreciation and earnings and profits in the foreign area presented all sorts of additional and formidable complications that could not be resolved in the time available. This burden of complexity is one of the most serious problems with legislation of this kind.

The key to tax administration in the foreign area is the development of knowledgeable personnel who can cope with its inherent complexities. I think it is fair to say that our Internal Revenue Service, despite its general efficiency and major expenditure of effort, has not developed an expertise which allows it to properly implement Subpart F. I do not think this is the fault of individuals. There are enormous difficulties in securing the necessary accounting data and translating it into the concepts of the statute.

Thus, we see very few cases in which the Internal

Revenue Service has applied the technical Subpart F provisions to taxpayers. After eight years, we see little indication that the legislation admits of practical tax administration.

Similarly, the United States has had since 1937 complex foreign personal holding company provisions which deal with so-called "incorporated pocketbooks" located abroad. There have been very few cases involving application of the foreign personal holding companies provisions. In short, the major impact of the kind of legislation represented by Subpart F may be merely its in terrorem effect.

From the standpoint of taxpayers, however, compliance with Subpart F has presented troublesome problems. Those that are conscientious have had to undertake considerable study, development of data, and internal tax and management controls. I can assure you that if the 1961 Kennedy proposals were renewed today, the opposition to Subpart F would be even more vehement than in 1961. Unlike most areas of tax reform, where the taxpayers learn to accommodate themselves to change and after a period of years accept the new provisions, Subpart F is one where greater experience has only led to greater hostility to the provisions. In many cases, I suspect

taxpayers simply ignore some of the complex provisions whether out of lack of understanding or a general feeling that they will not be applied by the Internal Revenue Service.

While the White Paper purports only to set forth a general description of the new law, it may be sowing the seeds for the same type of tax complexity for which we Americans are so uniquely noted. For example, the White Paper seems to define controlled foreign corporations as those 25 percent owned by Canadians. Will constructive ownership rules apply in deciding who owns 25 percent? Will the Canadian shareholders be taxed if they own only a minority interest and are unable to secure a distribution to pay the tax? Will they be taxed if the foreign income is blocked from distribution by currency restrictions? Will they be taxed if income is distributed? If they are taxed, will provision be made to allow them to withdraw earnings without a further tax? How will the specific instances of tax avoidance be delimited? What kinds of accounting rules will apply in determining the amount of income to be taxed?

These questions -- and many more -- would have to be dealt with in adopting Subpart F-type legislation in Canada.

They are not susceptible of simple answers. The prospect is for legislation of great complexity and administrative burdens of heroic magnitude. I do not think that the American experience in this area offers any grounds for belief that the effort will be fruitful.

In closing let me express my great respect for the goals and standards which guided your Government in the preparation of your White Paper. It represents a monumental undertaking and has attracted worldwide interest. In the last analysis, the ultimate success of any legislation you may enact will depend upon fair and effective administration by your taxing authorities and upon understanding, acceptance, and voluntary compliance by taxpayers. Your final legislative action will lay the foundation for the sound attainment of these ends.

APPENDIX "E"

Canadian Export Association

INCORPORATED 1943

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SUBMISSION

BY THE

CANADIAN EXPORT ASSOCIATION

RELATING TO

THE PROPOSALS FOR TAX REFORM

MAY 1970

The Canadian Export Association is a non-profit organization maintained by about 400 companies for the purpose of fostering growth in Canada's export trade. The membership embraces a wide range of large and small exporting companies in primary and secondary industries, engineering firms with foreign operations, and the financial institutions, transportation interests, agencies, forwarders and others that provide essential services to Canadian exporters.

2. Because the system of taxation in Canada has an important bearing on export performance, this Association has a vital interest in the "Proposals for Tax Reform" and we are therefore grateful for this opportunity to submit views.

3. A striking measure of the significance of exports to the national economy today is that one half of all the goods produced in Canada is sold in foreign countries. The extent to which export trade has contributed to the growth of industrial activity in the past decade is indicated in the following table:

	($ million) 1960	1968
Gross domestic production *	15,532	27,620
Merchandise exports	5,390	13,574
Exports as per cent of GDP	34.7%	49.2%

* Value of GDP of goods producing industries (including construction and utilities) at factor cost, i.e. market value less indirect taxes.

Source: DBS National Accounts and estimates by the Economic Council of Canada based on up-to-date GNP data.

4. It is apparent that one of the key factors in the very substantial growth of the economy in the 1960's was the expansion of production facilities which collectively were set up to turn out goods in far greater volume than the domestic market could absorb. This export-oriented boom greatly enhanced employment, tax revenues and the efficiency of Canadian industry, particularly in the manufacturing sector where many companies have been enabled to rationalize production so as to become internationally competitive.

5. Many factors contributed to the unprecedented gain in exports in the past decade, e.g. growth of foreign demand, devaluation of the Canadian dollar, the Canada-US automotive agreement. But perhaps

the most important prerequisite was the existence in Canada of a tax regime which (a) encouraged a record high volume of direct investment in resource development and a broad range of secondary industries and (b) made exporting from Canada generally competitive with exporting from other countries.

6. While few Canadians will quarrel with the "fairness and equity" objectives of the White Paper, we submit that one of the most important questions as yet unanswered is whether these objectives should be given top priority at this time. Despite the remarkable record of growth in recent years, the nation is confronted with serious economic problems today which the White Paper proposals clearly are not designed to solve. (The authors in paragraph 1.10 admit "the second main objective is to see that the tax system does not interfere seriously with economic growth and productivity".)

7. For the following reasons, we submit that the most important objective of fiscal policy for the 1970's must be to maintain a climate that will be conducive to rapid growth of direct investment, from every available source, in facilities to produce goods for export from Canada on an increasing scale:

(i) Growth of demand in the domestic market cannot be expected to generate sufficient expansion of industrial activity in the 1970's

- to provide the necessary volume and variety of new job opportunities to absorb the growing output of our schools and universities.
- to maintain an acceptable standard of living.
- to provide sufficient tax revenues to meet the rising commitments for educational, social welfare, regional and international aid programs.

(ii) Because the corporate tax has become a significant cost factor, tax considerations are essential in all corporate planning. Decisions relating to the selection of new sources of raw materials, of sites for new factories or, in a multinational corporation, of a country in which to produce goods for world markets, will inevitably be based upon an analysis of after-tax returns.

(iii) Canada no longer has a monopoly on most of the primary resources whose development and export have contributed so heavily to the growth of the Canadian economy and

infrastructure in the past. Because of the relatively small domestic market and declining tariffs, Canada offers no special attraction for direct investment in manufacturing plants as compared with larger market areas.

(iv) Of all the economic forecasts for the 1970's, probably the most realistic, and most important for Canada, is that the world will become increasingly competitive not only in terms of trade but also in the scramble for investment capital, as more and more nations strive to cope with balance of payments and national economic problems.

8. In view of the current public discussion of the costs and benefits of foreign control of Canadian industry, it should be noted that foreign subsidiaries conduct over one half of Canada's non-agricultural exports. A comparison of United States and Canadian statistics for 1965 (latest year available from the U. S.) shows that American subsidiaries in that year accounted for about 48% of Canada's exports of manufactured products and 66% of resource materials.

9. While direct investment by Canadians has risen substantially, it is apparent that the remarkable growth of the Canadian economy in the past decade could not have been achieved without the high inflow of foreign investment. Many foreign-based corporations established, expanded or modernized plants in Canada in that period. In addition to investment capital and technology, they have provided captive markets for an increasing proportion of their Canadian output, along with international marketing and credit organizations which enable them to develop arm's-length export sales far more readily than locally-owned companies.

10. We share the view that, despite the desirability of greater Canadian investment in Canadian industry, an acceptable rate of economic growth in the years ahead will be attainable only with a continuing inflow of direct investment capital. For this reason, we believe it is of particular importance that fiscal and other policies must encourage and not discriminate against foreign investors. In some important ways, the proposals seem designed to discourage foreign investment.

11. The foregoing constitutes the rationale for our views on the White Paper which are divided into two parts: (a) comments of a general nature and (b) a review of the implications of specific proposals that relate more or less directly to export performance.

GENERAL COMMENTS ON THE WHITE PAPER

12. We warmly applaud the Government for exposing the proposed changes in the tax system for public discussion rather than using the traditional method of legislation.

13. Our members agree that there are weaknesses in the existing tax system which are in need of correction. However, we are genuinely concerned over both the timing and the breadth of the proposed overhaul of a tax regime that is manifestly serving the Canadian economy well today.

14. We believe that this is a most inappropriate time for a major revision of Canadian tax policy because of the impending tax changes and reductions in the United States, and in the light of Canada's need for economic growth in the years ahead.

15. Fearful of the impact of the far reaching proposals on business and individual initiative, capital formation, foreign investment and other factors essential to economic growth in Canada (especially inflation), we are of the opinion that:

(i) weaknesses in the existing system should be corrected, and specific abuses eliminated, by changes in the present law and/or regulations, and

(ii) greater equity in the distribution of the tax burden could be attained with less risk to the economy if approached over a much longer period and in co-relation to future growth in the revenue.

16. Internationally-oriented companies have stronger reasons than others for deploring the proposed tax measures which differ substantially from those in effect in other nations, and which seem far more complex than necessary to fulfill the objectives of the White Paper, also the adoption of some measures which are as yet untried anywhere else and others which have been tried and abandoned by other nations.

17. We are most seriously concerned about the substantial increase in the tax burden which the White Paper discloses, which must inevitably impair Canada's international competitive position in terms of trade and foreign investment. Based on the information provided in the White Paper, we are not at all satisfied that the predicted gain of $630 million will not be far exceeded in five years time. We believe that much more evidence is needed to clarify and to justify the real revenue gains which the proposed system may produce, in order that the proposals can be intelligently appraised by the taxpayers.

18. We must deplore the apparent intention of the Government to divert an increasing proportion of the wealth of the nation from the private to the public sector. Such a step would clearly make this country a less attractive place for direct investment, by Canadian as well as foreign investors.

19. Because the stability of a tax system is important to private investors, we believe it is essential that, after eight years of public discussion at home and abroad about proposed Canadian tax reform, the present reappraisal should produce a system that will not only be in the best interests of the Canadian economy but also one that will clearly be seen to be viable for a long term and not require subsequent changes. The sheer complexity of the main White Paper proposals must raise fears about their stability.

20. To sum up the above general comments, we submit the following recommendations:

(i) the primary concern of the Government at this time should be to sustain a rapid rate of growth of industrial activity in the private sector.

(ii) to this end, the existing tax structure should be maintained, with amendments to eliminate loopholes and tax abuse and to correct weaknesses, e. g. to provide allowances for child care and moving to a new job.

(iii) "greater equity and fairness" measures should be undertaken gradually over a much longer period, as growth of revenue permits and in ways which would not impair private initiative and economic growth, starting at a time when the economy is in a better position to absorb the shock of such changes.

(iv) in light of the disparity between United States and Canadian tax levels, an immediate objective should be to reduce rates in Canada, particularly of the corporate tax.

(v) it is of utmost importance that the Government should remove as quickly as possible the aura of uncertainty created by the White Paper (and about its viability in light of possible provincial reactions) in the minds of corporate investors here and abroad. Investment plans under consideration today will have a significant bearing on the state of our economy in the years ahead. The question for investors is "Do we put it in Canada or elsewhere?" The common denominator in such decisions is the tax climate. Canada cannot afford to delay in reaching a decision to maintain a tax climate that will keep this country competitive in terms of direct investment.

TAXATION OF INTERNATIONAL INCOME

21. Among the most dangerous proposals in terms of their impact on future employment and economic growth are those relating to international income.

22. The authors of the White Paper (6. 9) recognize that Canadian business is often required to go abroad "to seek foreign sources of supply... to develop foreign markets... to achieve economies of scale which are otherwise denied them by the relatively small size of the Canadian domestic market". Then they proceed with a statement of the fact that "Canadian companies would find it hard to compete on the international scene if they were subject to more onerous taxes than those which apply to their competitors".

23. Incongruously, they follow with two proposals to restrict the long-standing tax exemption for dividends received from controlled foreign corporations which clearly are inconsistent with the above statements and could create a powerful deterrent to Canadian initiative in international business.

24. Canadian exporters face competition from corporations in other countries which provide various tax benefits for their exporters, including the ability to utilize low-tax jurisdictions and tax treaties in setting up foreign subsidiaries or joint ventures abroad to conduct selling distribution, processing or assembling operations. These corporations are enabled to compete more effectively with international and local producers in foreign markets by passing tax savings to their customers.

25. Since World War II, a growing number of Canadian companies have greatly enhanced their ability to compete in world markets as a direct result of the provision (Section 28(1)(d)) of tax exemption for dividends from controlled foreign corporations. Collectively, their exports have made a substantial contribution to Canada's economic growth and international balance of payments. Because Canada is a relatively high cost country, and in light of steadily rising ocean freight costs, these exporters would indeed find it hard to meet the prices of foreign competitors if their export income were subject to full Canadian tax.

26 Among the comments received from member firms, we believe the following deserve special mention:

(i) "The usual purpose of establishing foreign assembly and processing plants is not to save taxes but to overcome customs barriers or import restrictions. Rather than lose a market, the Canadian exporter will supply materials or components and have the foreign subsidiary do the final processing or assembly. Canadian exports are thus preserved."

(ii) "Companies commencing local manufacture in some foreign countries are frequently granted 'pioneer status' under which special tax incentives are provided for a limited period. The gross-up system would rob the Canadian companies of such incentives, thus putting them at a competitive disadvantage which could force them to abandon foreign markets. It should also be noted that the gross-up system would discourage Canadian investment in the developing countries."

(iii) "Foreign companies establishing plants in a common market area tend to select the country with the lowest income tax rates. Canadian companies would be denied this flexibility because the gross-up provision would always raise their effective income tax costs to the Canadian level, one of the highest in the world."

(iv) "If the proposed restrictions on tax exemption under 28(1)(d) are to stand, we should strongly recommend exemption from Canadian tax for all foreign dividends which represent distribution of foreign surplus accumulated before the White Paper. If Canada were to tax distributions of previously accumulated surplus, it would start an avalanche of distributions prior to the implementation date, which would then have to be lent back to the foreign subsidiaries. As there would be no benefit to the Canadian Government in triggering such an avalanche, distribution of pre-White Paper surplus should be permitted to continue on a tax free basis."

Dividend Exemption by Treaty Proposal

27. To continue the exemption only in case of dividends coming from countries with which Canada has concluded a tax treaty would be grossly unfair both to non-treaty countries and to Canadian corporations with existing investments in those countries.

28. Despite the economic leverage possessed by the United States, that country has had only partial success in negotiating bilateral tax treaties. It seems most likely that Canada will be unable, or at best take many years, to obtain treaties with certain nations for reasons of their own. We believe it is unrealistic to assume (6.50) that "by far the greatest portion of international income is expected to fall within the treaty system". Arrangements are required to allow a very long time (more than four years from 1971) for the negotiation of tax treaties necessary to Canadian industry.

29. In the light of the above considerations and to encourage Canadian initiative in the developing as well as the industrialized world, Section 28(1)(d) should be retained in its present form.

Passive Income Proposal

30. It is stated (6. 21) that "the government proposes to introduce provisions patterned generally on those in the United States" to counter "tax haven abuse" of the dividend exemption system.

31. Since the publication of the White Paper, senior officials of the U. S. Treasury Department have announced that the 1962 amendments to the Internal Revenue Code (the Subpart F provisions dealing with so-called tax-haven abuse) are not working in the interest of the U. S. economy and that they are to be amended in the year year or two. We draw your attention to the following significant extracts from a recent speech by Assistant Secretary of the Treasury, Edwin S. Cohen:

> "The current tax structure could be considered a system which inequitably treats those in industry and labour who seek to sell abroad.
>
> Income from export of goods manufactured in the United States is, in general, subject to full U. S. income tax unless the sales are routed through a subsidiary incorporated in the foreign country to which the goods are destined... the desirability of a tax system which produces this result is questionable, particularly in light of the fact that a number of countries effectively exempt from tax the export income of resident corporations."

32. For your information, we enclose (Appendix 'A') a summary of the main reasons why the United States is now making plans to revise its system of taxing international income, prepared for us by Mr. Walter A. Slowinski, Resident Partner of the international law firm of Baker & McKenzie in Washington, D. C., a highly regarded authority on the U. S. tax system. (His credentials are attached to Appendix 'A').

33. We also enclose (Appendix 'B') a paper produced by the U. S. Treasury Department proposing a form of long-term tax deferral for U. S. exporters by the creation of a new entity to be known as a "Domestic International Sales Corporation". This proposal has been discussed with various interested groups in the United States and, with some amendments, is expected to be redrafted as a Bill in the very near future. As soon as available, we will obtain copies of this Bill for your Committee. We submit that this initiative, though not yet legislated, is indicative of a trend in favour of tax preference for export income and is good reason in itself to discard the passive income proposal in the White Paper.

34. Without defining "tax haven abuse" or stating which American rules are to be adopted, the authors note that these proposals would add only $10 million annually to the revenue. Their adoption could

result in a loss to the economy (and the national revenue) of many times that amount, to say nothing of the high cost of compliance and collection.

35. We believe it would be sheer folly for Canada to imitate American rules and practices which (a) the U. S. Treasury admits are discouraging exports and encouraging foreign manufacture, and are now seeking to change, and (b) would clearly be contrary to the best interests of the Canadian economy.

36. We therefore recommend that the passive income proposals should be deleted from tax reform. However, we see nothing wrong with the government strengthening the personal company rules to prevent tax avoidance of the sort described at paragraph 6. 4 where individuals transfer Canadian assets abroad to avoid Canadian tax.

37. Canadian tax rules should clearly allow tax exemption for income from controlled foreign corporations which are set up to handle arms-length sales or distribution of goods or services anywhere outside Canada as well as those established to obtain raw materials, to process or assemble or to perform any other business or commercial operation.

38. To be consistent with Canada's economic objectives, we suggest that these rules should not only be designed to encourage exports and the development of Canadian-based international operations but also should be made known through trade and professional associations, to all Canadian companies that have the potential to expand by using them.

DEFINITION OF CONTROLLED FOREIGN CORPORATIONS, CREDITABLE TAX AND WITHHOLDING TAXES

39. We recommend that the cut-off point between a controlled foreign corporation and a portfolio investment should be 10 per cent, as in the United States rules, rather than 25 per cent. Canadian companies have been and will become involved in foreign ventures with less than 25 per cent because it was either all they could get or all they could afford.

40. The "flow-through" proposal (6. 29) in respect to withholding tax on dividends paid to a Canadian corporation by a foreign subsidiary, distributable to either Canadian or foreign shareholders with only one 15 per cent tax, seems eminently fair and desirable.

41. However, the proposal to increase the rate of withholding tax from 15 to 25 per cent is regrettable. In the event that Canada is unable for any reason to negotiate a lower rate under a tax treaty, we will have raised a significant barrier to the inflow of foreign investment capital. Existing loan arrangements in non-treaty nations could be put in jeopardy if an adequate "grand-father" clause is not provided, and debt service on future "Eurodollar" and similar foreign currency loans by Canadian corporations will be rendered much more costly if not impossible.

42. In this connection it should be noted that Canadian public issues are free of withholding tax so that this tax impediment to the availability of capital is imposed only on industry.

43. It is also relevent that in the United States, an American corporation can make foreign loans for reinvestment in its foreign and export operations free of U. S. withholding tax. This is a material competitive advantage which should be carefully considered for adoption by Canada.

44. Proposals with respect to foreign tax credits, i. e. to recognize as creditable by treaty income tax paid to polital subdivisions (Para 6. 26) and to allow carry-overs of foreign taxes in excess of those actually creditable in a particular year (Para 6. 25) are good. The proposal to limit tax is retrograde since certain countries require a withholding in excess of 15% in view of their tax systems.

45. In respect to tax treaties, we would urge your Committee to review the circumstances which caused the Minister of Finance in December 1962 to change the system so as to raise the withholding tax on dividends received by corporations from 5 to 15 per cent, thus eliminating the differential in the rates applicable to corporations and individual recipients, resulting in double-taxation. We suggest that the authors of the White Paper should be requested to satisfy your Committee on the reasons why Canada does not intend to adopt the ceilings established in the OECD Draft Convention of a 5 per cent rate for dividends, and a 10 per cent rate for interest payments, to corporations.

EXPORT INCENTIVES

46. Given the compelling need for rapid and sustained growth of export trade, Canadian tax authorities should actively be searching for tax incentives to encourage exports which would not attract foreign countervailing duties or contravene GATT rules. Other nations including GATT signatories are providing benefits which give an advantage to their exporters in the form of rebates of hidden taxes, adjustment of the tax system, the right to postpone tax payment, or special depreciation allowances.

47. Because of the important bearing on export and import trade of the value-added tax system prevailing in most of the European countries, and now being studied by other major nations including the United Kingdom and the United States, we suggest that our Government should be giving serious consideration to its applicability in Canada. Recent OECD statistics show that this country is more dependent on exports than any other member nation.

48. The Canadian Export Association has never before appealed for special tax incentives, mainly because of the fear of retaliation in the

form of countervailing duties, particularly in the United States. That country today is under pressure from the powerful National Export Expansion Council to provide incentives to encourage exports, including a proposal to adopt a value-added tax. Because we believe they may have important implications for Canadian tax policy in the years ahead, we enclose (Appendix 'C'), the most recent recommendations to the U. S. Administration by the N. E. E. C. Action Committee on Taxation, a group of 18 senior executives and professionals headed by Carl A. Gerstacker, Chairman, Dow Chemical Company.

49. We submit that Canada is in no position to lag behind in undertaking this sort of initiative. While Canadian exports have grown remarkably in recent years, world trade statistics show that we have no grounds for complacency: our 10 per cent gain in 1969 over 1968 was overshadowed by a 15 per cent gain in total exports by industrialized non-Communist nations.

TAXATION OF CAPITAL GAINS

50. The yield from the proposed capital gains tax is shown in Table 16 as $100 million annually yet it is predicted in para. 3. 55 that it could run to $390 million or more. Such a substantial addition to the tax burden must constitute a deterrent to both capital formation and private initiative, to say nothing of the impact of the system to be imposed.

51. Given the economic conditions in our capital-hungry nation, there is good reason to question the wisdom of putting a tax on capital gains at this time, let alone one that is more severe than that prevailing in most other countries. We do not believe that it should be imposed now.

52. In addition to its impact on capital formation in Canada, the proposed capital gains tax would be a serious disincentive for foreign investors since they could neither reduce its impact through tax-favoured profit distributions (they are denied foreign tax credits) nor deduct capital losses in other Canadian or foreign stocks. Only Germany and Holland appear to tax capital gains of foreign shareholders and they abrogate this tax in many of their treaties. Neither the United States or United Kingdom impose such tax and Article 13 of the OECD model treaty reserves the right to tax capital gains of foreign shareholders exclusively to their country of residence.

53. It is our impression at this time that the five-year revaluation for widely held corporations is to be abandoned. Equally unrealistic in our view is the assumption that Canada will be able to negotiate tax treaties with other nations (with different capital gains regimes) that will be needed to make the proposed system viable. Because of this and for competitive reasons it is felt that, if and when Canada moves into this field, our capital gains tax system should be entirely compatible with the United States system.

54. Special problems would arise in the taxation of capital gains in shares of controlled foreign corporations. The proposal to tax undistributed income, which under many conditions would have been tax exempt if remitted as dividends, is inequitable because there are rules and/or conditions (e. g. exchange control) in some foreign countries which outweigh parent company policy in respect to repatriation of surplus.

55. While the severity of the tax could effectively prevent needed rationalization, the denial of rollover privileges on foreign reorganizations would in the long run be more damaging to Canadian parent corporations than the rate of tax. Foreign operations require frequent reorganizations to conform to changing conditions at home and abroad. For instance, the recent United Kingdom tax changes made it necessary to convert U. K. subsidiaries to branches; rising nationalism, stringent government purchasing requirements and other economic considerations can necessitate change from branch to subsidiary; pressure to take in foreign partners may require foreign mergers, stock swaps etc.

56. Canadian companies would be at a tremendous disadvantage if such changes were to be taxed as dispositions, whether at a 25 per cent or 50 per cent rate. The resulting loss of flexibility could be disastrous. The United States and United Kingdom, our major competitors in world trade, provide their corporations with liberal rollover privileges for foreign reorganizations. Canada cannot afford to act differently.

57. Canadian companies with investments in various developing nations have been forced to sell all or part of their interests to host governments. Such expropriations or forced sales may bear no relation to initial investment or market value. Payment may come in the form of local government bonds for which there may never be a market. Canadian policy today encourages private investment to bolster development aid, and foreign investment insurance against non-commercial risks is available through the Export Development Corporation. To apply a capital gains tax in such cases seems inconsistent, unjustifiable and unfair.

58. The proposed rules for taxing individual capital gains could result in far-reaching disadvantages for the Canadian economy. Especially in the science-based industries which Canada is striving to develop on an international scale, skilled personnel are and will be in short supply. The capital gains tax proposal, along with the heavy increase in tax on the middle income brackets, will beyond doubt make this country less attractive for such people.

59. The proposal to tax unrealized gains on departure from Canada would disrupt the highly beneficial corporate practice of transferring personnel to and from this country. Transfers of executives with special skills or experience to manage a particular operation abroad, or of those being sent away for training or career development, are important to both the company and the individuals. Considering the amount of tax revenue involved, we strongly recommend that the proposal to tax gains on departure from Canada be eliminated in the case of business transfers.

THE CORPORATION AND ITS SHAREHOLDERS

60. The proposal (1.39) to alter the methods of taxing corporations by establishing a single rate of tax and providing a system of credits to shareholders for corporate taxes paid, with a distinction between closely-held and widely-held corporations, has evoked much criticism from our members.

61. The tenor of their comments is much the same as that expressed in the concise statement in Special Study No. 4 (March 4, 1970) for the Standing Senate Committee on Banking, Trade and Commerce:

> "To implement the proposal outlined in Paragraph 1.39, the authors of the White Paper deem it necessary to eliminate the lower rate of taxes allowed on the first $35,000 of taxable income, to confiscate by way of income tax any subsidies paid to encourage scientific research and the like, remove tax incentives allowed to the extractive industries and new industries in designated areas, and levy Canadian taxes on the earnings of foreign subsidiaries of Canadian companies."
>
> "The justification of this seemingly ruthless sweeping away of existing benefits to encourage industry is to grant tax credits to Canadian shareholders who may receive dividends from Canadian companies within a period of two and one-half years after the year in which the income is earned by the corporation."

62. Following is a summary of views expressed by our members:

(i) The proposed system would deter Canadian initiative in international business in that shareholders would be refused credit for foreign taxes paid by the controlled foreign subsidiary. As developing nations become more industrialized, their import trade changes so that, to maintain their position, Canadian exporters find it necessary to establish local processing or assembly operations. Successful Canadian exporters have also improved their competitive position by establishing foreign subsidiaries or joint ventures to handle sales, warehousing and distribution operations which must pay foreign taxes. All such arrangements are highly beneficial to the Canadian economy and therefore should be encouraged rather than subjected to discriminatory treatment.

(ii) We are concerned about the adoption in Canada of a system which has been used in only two other countries, and without success in either case. The experience of the United Kingdom, which abandoned integration in 1965, is referred to later. France, the only nation with a similar regime

today, has been forced under pressure from treaty partners to refund French corporate tax to foreign shareholders. Exporters have special reasons to want Canada to negotiate as many tax treaties as possible, and we fear that the reluctance to extend integration benefits to non-residents will create considerable difficulty in treaty negotiations.

(iii) One of the essential prerequisites for the development of a successful export business is a financially strong and viable domestic operation. The integration proposal seems destined to convert funds from investment to consumption and thus to impair growth of Canadian businesses. Further, the gross-up and credit method will inevitably produce restraints on corporate cash management whereas the financing of inventories and accounts receivable for exports demands a larger-than-normal supply of working capital.

(iv) The growth of Canadian industries will also be curtailed due to the "confiscation" of the various federal and regional tax incentives which is inherent in the integration proposal; the same applies in the case of dividends received by a Canadian corporation from another corporation which may not be paying sufficient tax to cover the dividend, e. g. by reason of high capital cost allowances. The proposal would destroy at the shareholder level the incentives and capital cost allowances at the corporate level.

(v) The two and a half year tax credit limitation discriminates against companies with fluctuating earnings, and may compel Canadian corporations to adopt dividend policies which are not in their best interests or which would make their shares less attractive to foreign investors.

(vi) Closely-held corporations would have a competitive advantage since they would have full integration while widely-held corporations would have one-half integration. We believe that public discussion to date has revealed the necessity of further clarification of the definition of these two entities, and of modifying this proposal.

(vii) Since the government would not grant a credit for foreign corporation taxes, this would discourage repatriation of foreign earnings by Canadian corporations, because such repatriation would dilute the tax credit which Canadian corporations could otherwise pass on to their shareholders. This would contravene the government's intent to encourage investment in Canadian assets.

63. It should be noted that the integration proposal would affect some corporations in different ways than others, depending upon their circumstances. A large majority of our members are opposed to the proposal

on the grounds indicated above, and for other reasons which are well described in another extract from Special Study No. 4 (referred to above) which is attached at Appendix 'D'.

64. It is apparent that the authors of the White Paper have three main objectives in putting forward the integration proposal:

(i) to give Canadians a stronger incentive to invest in Canadian corporations.

(ii) to relieve double taxation.

(iii) to offset or modify the harsh effects of the proposed capital gains tax.

65. A large body of opinion in Canada has expressed the view that all three objectives could be achieved equally well by an appropriate increase in the present dividend tax credit. Given the capital gains tax as proposed, it would be essential that one or other of the alternatives be implemented concurrently. Of the two, we favour the relatively simple and less complicated dividend tax credit system rather than the cumbersome new proposal which, if it were adopted, would require considerable change to accommodate the negative features described above.

BUSINESS INCOME - ENTERTAINMENT AND RELATED EXPENSES

66. The proposals relating to business entertainment expenditures appear to be based on the presumption that no benefit accrues to the company from the long-established, world-wide practice of entertaining customers or prospects. To the best of our knowledge, the only other government to adopt this position is the United Kingdom's, but there an exception is made in the case of overseas visitors.

67. The proposal to exclude from shareholder's dividend tax credits the corporate taxes paid because of the non-deductibility of such expenses, thus discouraging entertainment out of after-tax dollars, further accentuates the incredible desire of the authors to eliminate an accepted business routine.

68. To maintain the normal buyer/seller relationships with foreign customers, Canadian exporters simply must and will continue to entertain on the same basis as their competitors located in other countries. This is essential in the case of exporters travelling abroad. It also applies when actual or potential customers come to Canada, on their individual initiative or as members of an Incoming Mission sponsored by the Government of Canada.

69. The authors of the White Paper seem unaware of the fact that certain businesses rely more heavily than others on entertainment and personal contact than on advertising and promotion. Personal contact is especially important in foreign markets where local advertising for most Canadian export commodities is not feasible.

70. The denial of deductions for expenses incurred in attending conventions, seminars, or industrial exhibitions again seems to be based on the assumption that no business benefit is derived. One of the pre-requisites for success in developing export business is that the exporter keep himself closely informed on such matters as trade barriers, financing techniques, shipping, etc. as well as technological advances in his range of products, all of which entail participation in such functions.

71. We suggest that flagrant abuses of the type mentioned in the White Paper could be eliminated by establishing rules and guidelines under the present Act to define improper or unreasonable deductions. In a country so dependent upon export trade, it is inconceivable that the proposed double penalty on bona fide business expenses could be considered in the case of exporters.

72. In respect to capital cost allowance which is to be the subject of further study, we suggest that, while the present system has served us well by tending to encourage the replacement of assets rendered obsolete or uneconomic, Canada should examine the depreciation systems in other countries which may be deliberately organized to encourage export initiative.

73. The White Paper statement that the capital cost allowance rates tend to be on the generous side fails to recognize that the rate of technological advance is far greater in certain industries than in others. Electronic and aerospace industries, for example, would not readily agree that present allowances are overly generous.

74. The proposals with respect to nothings and the suggestions in recent releases of the Department of Finance that all business expenses would be deductible (such as interest, bond discounts and issue expenses, etc.) are good and should be supported.

75. Members of this Association point out that the installment payments of corporations are out of line with similar obligations in other countries to the extent that corporation tax must be paid before cash from sales is realized. This should be corrected to allow tax to be paid in some relation to business receipts, say a minimum of a 90 day delay throughout the year. This is particularly relevent to exporters where longer credit terms are generally required.

TAX INCENTIVES FOR EXTRACTIVE INDUSTRIES

76. As the resource industries represented in our membership are submitting their views on these proposals directly, it would be inappropriate for us to elaborate in detail here, or to plead the case of the companies directly affected.

77. There appears to be general agreement that the proposals to reduce the value of special tax incentives for extractive industries which were introduced in Canada over fifty years ago, and are matched in one way or another in other mining countries, would have adverse effects on the entire Canadian economy in the long run which would more than offset any benefits envisaged by the authors of the White Paper. We would like to reiterate the caveat that Canada no longer has a monopoly on most of the important primary resources, and to quote the following extract from the address by the President of Cominco at his recent Annual Meeting: "The Canadian mining industry would become the highest taxed mining industry in any industrial country in the world. A new copper mine in British Columbia would pay an effective tax rate of about 54%. A similar mine in the United States would pay only 32% under new tax regulations there. In Australia, the same mine, located in the New Guinea Protectorate where one exists now, would pay an effective rate of 33%."

78. We are opposed to these measures on the grounds that they would restrict growth in these important industries which would affect not only the companies involved directly but also their Canadian customers, the manufacturing and processing industries whose export performance is dependent upon the availability and price of industrial materials, and the wide range of manufacturers who supply them with capital equipment. Needless to say, there is also considerable worry about the long-term effect of these proposals on Canada's international balance of payments, and on employment in the service industries.

CONCLUSION

79. Our main preoccupations and recommendations in respect of the White Paper are condensed in the attached summary.

80. Our internationally-oriented members (a good cross-section of producing and service industries and not a "special interest" group) are in a better position than most Canadians to make judgements as to how the new tax proposals will in fact affect the flow of investment into Canadian facilities, the most important factor affecting future levels of employment and tax revenues.

81. We believe that the radical approach to tax reform is simply not appropriate for Canada. Ours is not an island economy but rather one that is, and for some time will be, heavily dependent upon the

world around us for trade, investment capital, technology and human skills. The novel proposals in the White Paper would in many ways curtail the flow of all these essential prerequisites for economic growth in this country.

82. In the final analysis, the taxpayers who stand to be affected by the proposals are human beings with human needs and desires, among which job security and economic well-being are matters of primary concern. In his report to the Minister of Trade and Commerce on "Financing Facilities for Export" dated May 14, 1968, Mr. J. Douglas Gibson ably described one of this country's major challenges:

> "The ability of this country to provide jobs for the rising generation in sufficient numbers, variety and interest at suitable rates of pay may well determine whether she can survive as an effective entity."

83. Only by sustaining growth of industrial activity can we meet this challenge. Therefore the important question today is not whether Canada should adopt certain tax reforms in the interest of purity but rather what will be their impact on export-oriented investment, the sine qua non of future industrial expansion.

84. Given the importance of the issues at stake, the authors of the proposals are unable to give a sufficiently precise answer to this question, which is understandable in view of their novelty and complexity.

85. To give Canadian industry a fair chance of meeting its obligations to society, we submit that the system of taxation in Canada must be kept compatible, and the level of taxation competitive, with those prevailing in other major nations.

APPENDIX A

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* RESIDENT COUNSEL

May 6, 1970

Mr. J. M. McAvity
President
Canadian Export Association
1080 Beaver Hall Hill
Montreal, Canada 128

Dear Mr. McAvity:

You will recall that when I spoke before the Canadian Manufacturers Association Export Trade Group in Toronto early in February 1970, I mentioned the difficulties United States companies were having in attempting to comply with the Subpart F provisions of the U.S. Internal Revenue Code inserted by the Revenue Act of 1962. My statements were made in light of the fact that Subpart F has been incorporated by reference in the Canadian White Paper, which was the subject of our discussions at Toronto.

I now write to confirm some of the points mentioned in our subsequent conversations and correspondence. The foreign income provisions of Subpart F emerged in the Revenue Act of 1962 as an embattled compromise after eighteen months of discussion of alternate Treasury Department positions presented to Capitol Hill in a series of sudden policy position changes.

Subpart F is now erected as a superstructure upon existing U.S. tax law, and it can be safely described as a series of the most complex tax provisions ever enacted in the United States.

You will recall our recent correspondence in which I forwarded to you not only the Law, Regulations, Technical Information Releases, Announcements, Revenue

Rulings and Revenue Procedures, but also the series of tax forms and instructions which have become a required burden of annual filing for U.S. companies subject to the Revenue Act of 1962. Now, almost a million words later and seven and a half years after enactment of the Subpart F provisions, little can be said in their favor. In fact, one of the Treasury Department policy officials responsible for Subpart F in 1962 has recently admitted publicly that Subpart F provisions are "complex and untidy" and in need of substantial amendments.

We understand informally that such a project is now underway within the Treasury Department, and hopefully we shall have an opportunity to comment on proposed revisions and amendments when the Treasury studies have been completed. The need for simplification in this area involves not only the best interests of American corporations competing with foreign competitors on foreign soil but also the best interests of the Treasury Department and the Internal Revenue Service where auditing agents and other enforcement personnel are frank to admit that the provisions are unworkable.

Subpart F superimposes on our existing tax system a long series of intricate and ambiguous taxing provisions, criss-crossed with equally perplexing rules for "relief" from their application.

Because of their deterrent effect upon American competitive effectiveness abroad; their lack of significant revenue consequences; their unwarranted burdening of the taxpayer with the alleged sins of the tax evader, and the extreme difficulty of their interpretation and application, the Subpart F provisions are now in need of prompt and fundamental revision with a fresh approach designed to remove tax impediments to American foreign trade and stimulate its growth.

The 1962 provisions impose upon American business ventures abroad burdens beyond those imposed on foreign competing companies owned or controlled by persons in other countries. No other major country imposes tax on its overseas business to the extent the United States has done in the 1962 Act.

I shall be pleased to review this letter and its contents with you at any time and to expand upon statements which have been made above at your early convenience.

With best regards,

Sincerely,

Walter A. Slowinski

"C O P Y"

WALTER A. SLOWINSKI is Resident Partner in the international law firm of Baker & McKenzie in Washington, D.C.

A member of the District of Columbia and Illinois Bars, Mr. Slowinski is Adjunct Professor of Comparative Tax Law, Georgetown University Graduate Law Center, Washington, D.C.; he is also a Lecturer in Tax Law at the University of Virginia Law School in Charlottesville, Virginia.

Current Activities:

President, Washington Foreign Law Society
Fellow, American Bar Foundation
Member, American Law Institute
Lecturer, American Management Association, New York City
Member, Council of the ABA Section of International and Comparative Law
Member, Committee on Foreign Tax Problems, ABA Section of Taxation
Vice Chairman, Committee on Treasury Department, ABA Section of Administrative Law
Member, American Judicature Society
Member, Editorial Board, American Institute of Certified Public Accountants publication -- "The Tax Adviser"
Lecturer, Foreign Service Institute, U. S. Department of State, Washington, D. C.
Chairman, International Law Committee, Bar Association of the District of Columbia

Past Activities:

Secretary, American Bar Association Section of Taxation (1952-53)
Former Member Board of Governors, Tax Institute of America, Princeton, New Jersey

Education:

St. Vincent College, Latrobe, Pa., B.S. in accounting (summa cum laude)
Catholic University of America Law School, Washington, D. C., J.D.

Other Activities:

Witness for American Bar Association before Congressional Committees on Revenue Act of 1954
Witness for Chamber of Commerce of the United States before Congressional Committees on Revenue Act of 1962

"C O P Y"

APPENDIX B

CONFIDENTIAL - NOT FOR PUBLICATION

February 17, 1970

Highlights of
Domestic International
Sales Corporation Proposal

There is outlined below a tentative proposal now under consideration in the Treasury for modification of existing United States tax rules relating to exports. This proposal would provide for deferral of Federal income tax on export profits and would accomplish this by establishing a special tax regime for domestic international sales corporations (DISC).

Outline of Proposal

In General

The proposal calls for special tax rules to be applied to a defined entity called a domestic international sales corporation. A domestic corporation would qualify as a DISC if it met the following conditions:

(1) Most of its gross income (say 95 percent) is derived from --

--export sales (determined by a destination test rather than by technicalities of place of passage of title);
--the performance of services ancillary to its sales;
--the leasing or rental of export property;
--interest received on loans made to finance the acquisition of plants, machinery or equipment in the U. S. used in export production (export manufacturing facilities);
--interest on obligations issued or guaranteed by the Export-Import Bank or F. C. I. A. ; and
--other transactions and activities related to its exports; and

(2) most of its assets (say 95 percent) are export-related, including--

--working capital necessary to meet the reasonable needs of the corporation;
--plant, machinery and equipment used in the sale, storage, packaging, servicing, assembly or transportation of its exports;
--obligations issued or guaranteed by the Export-Import Bank or F. C. I. A. ;
--assets of foreign sales branches handling the U. S. exports;
--stock or securities in a controlled foreign corporation engaged in marketing the DISC's exports; and

--obligations representing loans to domestic producers to finance the acquisition of export manufacturing facilities.

With respect to loans made by the DISC to finance the acquisition of export manufacturing facilities, the annual gross income from such loans (less any dividends paid out of earnings of that year) could not exceed 50 percent of the DISC's annual gross income from all sources.

Tax Treatment of DISC Profits

So long as the domestic corporation continued to qualify as a DISC its retained earnings would be exempt from U. S. income tax. Upon a dividend distribution, liquidation, or sale of the shares, those earnings would be taxed to the shareholders as ordinary income. The dividends received deduction would not be available, since the DISC incurred no U. S. income tax. With respect to foreign taxes paid by the DISC, a foreign tax credit would be available to the corporate shareholders. Dividends of a qualified DISC would be deemed at least in part to be foreign source income and excess foreign tax credits available from other sources could be applied against U. S. taxes on the dividends.

Profits Attributable to the DISC

It is contemplated that export sales by the DISC to its related foreign purchasers would be made on an arm's-length standard under existing income allocation rules. However, the sale of goods for export by the domestic manufacturer to the DISC would be subject to a different allocation rule which would enable the DISC to earn a profit in excess of the profit which would be attributable to it under the existing allocation rules.

Rationale

The DISC proposal proceeds from the view that exporting businesses in the United States operate under a tax disadvantage as compared to foreign manufacturing subsidiaries of U. S. corporations and as compared to foreign suppliers, each of which seek to supply the same foreign market. The disadvantage inheres in the fact that, apart from certain situations which are dealt with under "subpart F" (Internal Revenue Code S951 et seq.), the U. S. tax on the earnings of a foreign subsidiary of a U. S. parent is deferred until those earnings are repatriated, whereas a domestic exporting corporation is taxed on its earnings currently and many foreign suppliers are subject to tax at rates considerably below the U. S. level. Permission to operate an export business through a domestic corporation under U. S. laws and accounting systems would also simplify operations materially as contrasted with operations through foreign corporations.

The DISC proposal, therefore, is a reform designed to achieve equality and simplification by treating a domestic exporting subsidiary

on the same basis as a foreign subsidiary so that U. S. tax on export income derived by the DISC would be deferred until the DISC distributes its income to its shareholders. So long as the domestic export corporation continued to earn qualified income and continued to invest in qualified assets in the proportions required, if no dividends are paid no Federal income tax would be incurred.

It is contemplated that generally tax-free reorganizations would be permitted in order to telescope existing foreign operations into a DISC or to put existing foreign sales subsidiaries under its ownership where desired.

Some Significant Aspects

In examining the potential value of this proposal, there are four aspects which should be given particular consideration: the significance of deferral, investment of profits in export manufacturing facilities, the determination of export profits and the treatment of dividend distributions made by the DISC for purposes of the foreign tax credit.

While deferral of tax for a relatively short period, such as a year or two, would be of limited significance, deferral for a substantial period reduces significantly the impact of a tax and, of course, deferral that lasts indefinitely can have substantially the same effect as an exemption from tax. Since the proposal would permit profits of a DISC to be invested in export manufacturing facilities as well as in export sales facilities, it would appear that in many instances the deferral provided by this proposal would be for substantial periods.

The only limitation on deferral would be that the income from financing export manufacturing facilities in any year (less dividends paid by the DISC with respect to that year) could not exceed the corporation's income for that year from export sales activities. This would mean that after a time the DISC would have to make distributions of its income in order to prevent the income from financing export manufacturing facilities less dividends from exceeding income from export sales activities.

Since export profits (income from export sales activities plus income from financing export manufacturing facilities) would be deferred only as long as they are retained by a corporation that qualifies as a DISC, amounts paid as dividends would at the time of distribution be subject to tax as the income of its parent or other shareholders. Our rough calculations, based on assumptions which we believe to be typical, indicate that where export profits are deferred, the proposal would not require the distribution of export profits earned by a DISC during ten years after enactment. Where export profits follow a rising curve, this period would be longer.

As indicated, the profits of the DISC could be invested in export manufacturing facilities, subject to the limitation described above, on

income from such investments. The typical investment by a DISC in export manufacturing facilities, we believe, would be a loan by the DISC to its parent corporation to help the parent finance new manufacturing facilities. This would result in the DISC receiving interest. It is not contemplated that we would require the loan to be traced to specific manufacturing facilities or equipment which will actually produce for export as long as the ratio of the financing supplied by the DISC to total new investment in manufacturing facilities does not exceed the ratio of the manufacturer's export sales to total sales.

The third aspect to be considered is the provision for special rules for the allocation of income between a related manufacturing corporation and the DISC. The thought here is that part of the income now earned by corporations manufacturing in this country for export would be treated as constituting export profits which could be earned by a DISC. Under this approach, a substantial amount of income could be allocated to the DISC, whether the DISC exports to related or unrelated customers in foreign countries. In addition, exporters would be encouraged to allocate to the DISC substantial functions involved in export sales, and to the extent this occurs the income which would be allocable to the DISC would increase.

Finally, it will be possible in many instances to conduct export sales through the DISC with relatively low foreign taxes on the sales income. Dividend distributions from a qualified DISC will carry such foreign taxes as foreign tax credits and will be deemed to be foreign source income at least to the extent of the export sales income of the DISC. To the extent that the foreign taxes on the DISC are lower than the U. S. corporate rate, a corporate shareholder will be able to use excess tax credits from other foreign source income against U. S. taxes on the DISC dividends.

APPENDIX "C"

REPORT AND RECOMMENDATIONS OF THE ACTION COMMITTEE ON TAXATION, NATIONAL EXPORT EXPANSION COUNCIL NOVEMBER 4, 1968

Recommended Administrative Action

1. The Administration should increase its efforts to have the GATT rules on export subsidies changed to permit rebates or other tax concessions relating to direct taxes in addition to the existing provisions permitting rebates of indirect taxes.

In connection with its efforts to have the GATT rules changed, the Administration should prepare proposals for legislative action allowing special tax treatment in connection with exports, possibly in the form of (a) additional capital allowances relating to equipment used to manufacture goods for export, (b) incentive deductions for promotion expenses in connection with export sales, and (c) special tax rates on income generated from export sales. A determination should be made as to whether such export incentives should be granted on all exports, on increases in exports, or on exports of small businesses.

2. The Administration should sponsor a formal study of the advantages and disadvantages of substituting a value added tax or other broad base turnover tax as a major source of revenue in place of part of the revenue raised by our existing income tax. Such a study should determine the possible effects on exports of changing to a turnover tax system.

3. The Administration should consider further changes in the regulations under Section 482 of the Internal Revenue Code to provide "safe havens" for certain types of export activity involving U. S. parent companies and their foreign sales subsidiary or Western Hemisphere Trade Corporation subsidiary. As one possibility, the regulations could provide that if a certain fixed percentage of the overall profit on the sale of goods has been recorded on the parent company's books, then no allocation would be required even though the pricing formula used did not exactly fit any of the permitted procedures spelled out in the regulations.

Recommended Legislative Action

We recommend the following legislative action: (1) The adoption of a rebate on exports and a border tax on imports based on existing indirect taxes covered by federal, state and local governments in the United States; and (2) the liberalization of the Export Trade Corporation provisions of the Internal Revenue Code.

Discussion:

The thrust of the NEEC Tax Action Committee's report is toward

more favorable tax treatment of export earnings as an encouragement to greater export effort by American industry. The Committee's original recommendations were in two parts, those changes which could be accomplished administratively by the Treasury and those which could be accomplished only through legislation. The current recommendations merely update the original proposals.

The chief administrative recommendation, in the Committee's original report, was that Treasury should issue clarifying regulations on the question of inter-company pricing, i. e., prices charged by U. S. parent firms in sales made to their foreign subsidiaries. The problem stems from Treasury's exercise of its authority to reallocate income as between a U. S. parent and its foreign subsidiary if pricing practices were such as to reduce the parent's selling profit (and income tax liability) below what it would have been had the transaction been with an unrelated customer.

After several years of drafting work, during which Treasury considered the views of the business community (including NEEC) and the accounting and legal professions, inter-company pricing guidelines were issued on April 16, 1968 slightly more liberal in their over-all approach than previously.

Although the new regulations reaffirm the "arm's length" standard for transactions between affiliated companies, some broadening changes were clearly included. It should be of some benefit to industry to have the clarification provided by the new rules and particularly to have it recognized that sales below manufacturing costs can be made, not only to establish a new market but also to help maintain a threatened market.

Taxpayer representatives are concerned because pricing formulas used between parents and subsidiaries for extended periods of time do not appear to fit exactly in the formulas prescribed by the new regulations. In the NEEC Tax Action Committee's original report we did not recommend "safe haven" provisions in the regulations but we now feel it would be advisable for the Treasury Department to consider some such provisions. One possibility would be a rule that where prices between a U. S. parent and its foreign subsidiary permit the parent to book a certain percentage of the overall profit then the regulations would not require a reallocation even though the pricing formula used did not fit any of the permitted pricing procedures in the regulations. Such a "safe haven" provision would be consistent with the treatment in the Regulations of interest on inter-company loans.

The NEEC legislative recommendations have not been put into operation. In this connection it should be noted that even prior to the adoption by the NEEC in April 1966 of the report of its Tax Committee the fiscal climate was unfavorable. The Tax Adjustment Act of 1966 had been signed into law in March and it was a tax increase measure in effect which accelerated the payment of more than $6 billion in additional revenue.

Then in October 1966 the 7% investment tax credit was suspended for 15 months. Under the circumstances, a positive approach to the NEEC tax proposals was unlikely.

Treasury tax policy and finance specialists, working with other concerned agencies, Commerce included, have done a considerable amount of work on export tax incentive plans. The views of industry were gathered in a series of interviews conducted by a Treasury-Commerce team headed by Assistant Secretaries Knowlton and Shaw. In consequence, there now exists a body of information concerning tax incentive plans for exporters which could be used as the basis for an action program, contingent on a decision by the Executive branch to institute an export tax incentive.

The NEEC has also urged that "in view of the President's comments on such border taxes in his balance of payments message of January 1, 1968 ...the U. S. adopt a system of border taxes and rebates on exports based on existing indirect taxes imposed by State and local governments as well as the Federal Government." In this regard, the U. S. has initiated an active international campaign, both in the OECD and in the GATT, for the reexamination and reconsideration of the rules governing border taxes.

We continue to recommend that a system of export rebates and border taxes on imports be adopted for this country. Much of the opposition has been based on the fact that Treasury studies indicate such compensating rebates and taxes could only be justified at a level of 2 to 3% and this would not constitute an important incentive to export. We call attention to the fact that European systems of export rebates and border taxes are based on estimates of the impact of turnover taxes and that these border taxes have never exactly duplicated the domestic turnover taxes in any country prior to the adoption of the value added tax in Germany. On the same basis, a 5% rebate and border tax in this country would appear to be reasonable. It would also provide enough stimulus to exports and discouragement to imports to make it more than a token tax.

We reiterate our recommendation that the export trade company provisions be liberalized but we again point out that a more satisfactory and permanent solution would be to change the GATT rules to permit more flexibility in handling exports under a system of direct taxes. The theory that direct taxes and indirect taxes are substantially different in their impact on the price of goods seems to be losing support. It would enable this country to explore several interesting methods of using taxes to encourage exports if the GATT rules were changed. It would also avoid the drastic change and numerous problems involved in the switch to a value added tax as a major source of revenue in this country. We again recommend that the value added tax be studied in order to place us in a competitive position with European countries if the GATT rules are not changed.

APPENDIX "D"

EXTRACT FROM SPECIAL STUDY NO. 4,

STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

The system of grossing-up dividends proposed for Canada by the authors of the White Paper was first introduced in Great Britain in the mid-1800's at a time when the principles of taxation were being developed on a trial and error basis.

This system has in more recent years been progressively abandoned by Great Britain as failing to meet the demands of governments.

The grossing-up system was finally abandoned by Great Britain in 1965. An extract from the Budget Statement of the Chancellor of the Exchequer of April 6, 1965, may be of interest to members of the Standing Committee. It follows, with underlining inserted by your advisor:

> "Our present method of taxing corporate bodies goes back to the days before the joint stock company, as we know it, existed, when the few companies that did exist were thought of as being in the nature of large partnerships. At that stage, income tax was virtually a flat-rate tax: it applied to the income of companies and individuals alike; and when a company distributed its income to its shareholders in the form of a dividend, a second lot of tax was not exacted. Since those days, there have been extensive changes both in the tax system and in the status and position of companies.
>
> First, the personal income tax has become a graduated tax, differentiated according to the circumstances of each taxpayer, and made progressive by reduced rate relief at the lower end of the scale, and surtax at the upper end. Secondly, company taxation has been altered by the introduction of profits tax, which is imposed on the whole profits of a company, whether or not distributed, and is not repayable to shareholders. These changes have made obsolete the idea that companies and individuals should be treated for tax in the same way. By separating formally the two taxes, namely, the tax on corporations and the tax in individuals, we shall be bringing the tax system of the United Kingdom into line with reality and adopting what has become the general practice throughout the world.
>
> Hitherto, any idea of reforming the tax system by introducing a corporation tax in this country has foundered because of the widely held view that to levy a separate tax on company profits which is distinct from and additional to, the income tax levied on individuals would constitute 'double taxation' of company profits. The profits tax already contradicts this argument. The truth is that only part of a corporation's income is distributed to the shareholders in the form of dividends; the rest is not part of personal income and cannot be treated as such. The majority

Appendix 'D' - Cont'd.
Page 2

of the Royal Commission on Taxation came near to this view when it said:

> 'We accept the necessity for subjecting company profits to a special tax regime that is something more than a mere attempt to collect personal income tax in advance.'

But it baulked at the logical conclusion, which is that there should be a separate tax on the profits of corporations quite distinct from the income tax that is levied on distributed profits.

There then remains the questions of how to frame the tax on company profits. As soon as it is divorced from the taxation of individuals, we are free to draw it up on principles most conducive to economic growth and efficiency. The two ways open to us of raising the same amount of revenue from corporations are, either to confine the tax to undistributed profits and levy it at a relatively high rate; or, alternatively, to impose a tax on the whole profits, irrespective of distributions, at a much lower rate.

The latter tax, in my view, has a much greater economic and incentive value than the former. A tax confined to undistributed profits penalises investment and growth; it severely handicaps the young and dynamic companies which may rely on ploughed-back profits for expansion. A tax on the whole profit has the opposite effect. It makes it possible to shift the burden of taxation in such a way as to relieve the faster-growing companies, which are generally low distributors, and thus enable them to expand even faster. It will place more of the burden on those companies which are high distributors. It gives a strong incentive to all companies to plough back more of their profits for expansion. Finally, the incentives to cut costs and to raise efficiency through new investment are much stronger, and must be much stronger when a lower percentage of additional profits is taken in taxation than under the present system where 56-1/4 per cent of any additional profit would go to tax.

The present system is also unnecessarily complicated because of the existence of two taxes - income tax and profits tax - levied broadly on the same income but according to different rules. It is a patchwork system and it is not standing up to the strains that result from the efforts of Governments to use the tax system for economic purposes. The result has been the growth of abuses and anomalies, such as recovery by companies or individuals of large sums from the Revenue by way of repayment of tax, although no corresponding sum has ever reached the Exchequer."

APPENDIX "F"

ALCAN ALUMINIUM LIMITED

COMMENT ON PROPOSALS FOR TAX REFORM

PRESENTED BY THE MINISTER OF FINANCE, 7 NOVEMBER 1969

INDEX

30 April, 1970

ALCAN ALUMINIUM LIMITED

COMMENT ON PROPOSALS FOR TAX REFORM

PRESENTED BY THE MINISTER OF FINANCE, 7 NOVEMBER 1969

SUMMARY

Alcan does not quarrel with the White Paper's proposed adoption of the integration system, a capital gains tax and measures designed to minimize tax avoidance. Alcan, however, disagrees with a number of the specific ways in which the White Paper proposes to deal with these problems and it offers recommendations designed to meet its objections without detracting from those main objectives.

Our brief also takes exception to the generally high level of tax rates suggested and specifically cautions against letting the tax reform proposals unnecessarily produce higher corporate taxes as a side-effect.

The fundamental basis of our recommendations on the subject is that just as Alcan must preserve its ability to compete in its field, so must the Canadian fisc make due allowance for all the competitive aspects of its tax system as it affects business and individuals. This is particularly important for a country with an open economy such as Canada.

During the past decade the world aluminum industry has witnessed high growth coupled with a relatively low return on investment. The industry is very capital-intensive, and as such it is sensitive to high taxes which tend to reduce the volume of earnings retained for growth, as well as the return to shareholders.

Within this industry Alcan, a Canadian company, is the second largest producer of aluminum in the world and the largest single factor in international trade in aluminum. It is one of Canada's largest exporters. Since Alcan exports the bulk of its aluminum ingot production it is at some relative disadvantage vis-a-vis other producers from the dual standpoint of delivery costs and of tariff barriers. In addition, during the last decade Alcan has been taxed more heavily than its main competitors.

Alcan needs a Canadian tax system which will enable it to remain internationally competitive, i.e. one in which the level of tax is not higher than that imposed on similar enterprises elsewhere and which is compatible in form and structure with the systems of other developed countries. The White Paper proposals as now formulated do not meet these two criteria and will affect Alcan's position adversely.

There are four main areas of concern:

I. Integration needs to be modified so that:

a) it is possible eventually to reduce the present corporate tax rate of 50% to the level applied in most industrial countries -- presently around 45%.

b) dividends paid by one Canadian company to another are exempt from tax so that income is only taxed once in the hands of a corporate group; and definitions are adjusted so that a fully owned subsidiary with preferred shares only held by the public can be classified as a closely-held company so that dividends to its parent need not be taxed.

c) Canada makes itself ready if necessary to see that foreign portfolio shareholders receive the same integration benefits on Canadian shares as domestic shareholders.

II. Capital gains tax should be levied on only half of all long-term gains as in the U.S.A. and generally not on gains on a deemed realization basis.

III. The White Paper personal tax rates tend to put too much load on the middle income ranges, i.e. on Alcan's factory employees and its middle management. Canada should adjust its total tax demands and the distribution of its tax load to approximate those of other industrial countries.

IV. Many of the proposals designed to deal with international tax avoidance need modifying or they will impose an unjustified extra tax load on normal bona fide international operations.

Our brief and technical appendix review the above matters in more detail. The technical appendix also contains a discussion of certain other significant problems including:

Integration - problems arising from distinguishing between closely- and widely-held companies, taxation of unrealized intercompany profits, the 2-1/2 year period within which tax must be related to a dividend to be creditable and the proposal for a 15% tax on pre-implementation surplus;

Capital gains - the taxation of gain on sale of a principal residence and the use of cost or market in the valuation of assets held at date of implementation;

Individuals - increasing the number and amount of deductions available, the treatment of pensions and pension funds and the general averaging option;

Business and property income - the deductibility of all legitimate business expenses which should be a beneficial aspect of integration,

the disallowance of net losses from rentals and the disadvantageous present arrangement for the installment payment of corporate income tax.

Alcan is part of Canada's international effort in a very competitive world and an important earner of foreign exchange for Canada. Modifications need to be made to the White Paper proposals, while leaving their basic structure intact, to enable Alcan to maintain its present position and if possible to improve it.

ALCAN ALUMINIUM LIMITED

COMMENT ON PROPOSALS FOR TAX REFORM

PRESENTED BY THE MINISTER OF FINANCE, 7 NOVEMBER 1969

General introduction

Alcan Aluminium Limited(Alcan) is a multinational company incorporated in Canada with head offices in Montreal. The Alcan group is the second largest producer of primary aluminum in the free world, accounting for some 15% of total output, and the largest international trader in aluminum being responsible for 40% of total world exports. It includes some 70 companies carrying on active operations in most countries of the Western world.

It is a widely-held company with over 72,000 shareholders. 35% of its shares are owned in Canada, and no individual or group anywhere owns as much as 4% of the stock. Appendix I attached provides a fuller description of the company.

Alcan makes major contributions to the Canadian economy providing it with:

a) employment. Approximately 19,000 or 30% of Alcan's employees are located in Canada drawing over $160 million in annual payroll, i.e. about half of Alcan's total payroll.

b) exports. About 85% of Alcan's Canadian primary output is exported, yielding some $400 million p.a., nearly half of this coming from the U.S.A.

c) taxes. Alcan's total Canadian taxes in 1968 amounted to approximately $58 million.

d) capital. The debt money raised outside the company to finance expansion and investment has come mainly from the U.S.A. and not out of Canada's limited capital resources.

The world aluminum industry is intensely competitive and both its prices and its profits are relatively low. International ingot prices are today only 40% higher than in 1939 whereas Canadian consumer prices are 160% higher. During 1964-68 the average profits after tax of the world's 4 largest producers including Alcan have been 9.4% on shareholders' equity as compared with 12.4% for U.S. manufacturing industry as a whole.

In this very competitive world Alcan suffers two disadvantages.

a) 70% of its total sales, including metal from other sources as well as Canada, are export sales as compared with an average of 25% for all other free world aluminum producers. Ingot sales today realize about 25¢/lb. and export sales are burdened as compared with domestic sales with an extra 8% to 10% of realized sales value for duty and transport costs. Low cost hydro electric power no longer offsets those disadvantages to the same extent as in the past as technological

advances have reduced the cost of thermal power.

b) it pays higher taxes than its major competitors. During 1964-68 total Alcan taxes, (Canadian and foreign; income, property and sales) have been 8.1% of sales as compared with an average of some 6.7% for the three chief U.S. companies, Alcoa, Kaiser and Reynolds. If Alcan had paid tax on the same basis as the U.S. companies it would have paid $66 million less in taxes during 1964-68.

The aluminum industry needs especially large quantities of capital. Alcan requires $2.42 of gross assets for every $1.00 of gross sales as compared with $1.06 for U.S. manufacturing industry as a whole. High taxes affect Alcan's competitiveness because they reduce the volume of the company's retained earnings available for reinvestment in the business, the return to its shareholders and its ability to attract new finance.

If Alcan as a widely-held international company is to remain competitive it needs a tax system which:

a) does not impose significantly heavier taxes, either on the corporation or on its employees and shareholders, than those imposed on its competitors

b) is compatible with the tax structure of other industrial nations as to what is taxed and when.

This brief is designed to point out where and how the proposals in the White Paper will affect Alcan's relative competitive position. Except insofar as Alcan's health affects that of Canada it does not attempt to assess the possible overall economic and social effects on Canada of the proposals contained in the White Paper.

Alcan's areas of concern fall into 4 main categories -- integration, capital gains, taxation of individuals and taxation of international income. The balance of this brief reviews the above causes of concern in more detail. In addition certain technical problems of the new tax proposals are discussed in Appendix II attached.

I. The proposed new integration system

Under the proposed integration system Canadian shareholders will obtain an allowance for Canadian taxes paid by corporations instead of the present 20% dividend tax credit. The proposals have three main disadvantages for Alcan which are detailed below, and it is recommended that these be remedied if integration is adopted. In general integration is viable for Alcan provided these amendments are made.

The three disadvantages are as follows:

a) integration is likely to make it impossible for Canadian corporation taxes to be reduced to internationally competitive levels unless the scheme is amended. A suggested amendment to facilitate a lower corporate rate is detailed on pages 14-15 in the technical

appendix II.

Without this amendment, integration requires that corporation tax rates and the highest individual tax rates be fixed at the same level (in the White Paper each is 50%) so that the owners of businesses which can be carried on either as individual proprietorships or as closely-held corporations will pay the same amount of tax whichever form they adopt. As the maximum individual rate is unlikely to be reduced below the 50% rate suggested in the White Paper this means that the corporation tax rate, which applies to widely-held as well as closely-held companies, is also unlikely to be reduced below 50%.

A Canadian corporation tax rate of 50% is not competitive with rates of around 45% in many industrial countries such as Australia, Germany, Japan, Netherlands, Norway, U.K. and of 48% in the U.S.A.

b) the integration principle is to be applied to intercompany dividends paid by one Canadian company to another which at present are exempt from tax in the hands of the receiving company. The White Paper proposes to collect tax on intercompany dividends, where the subsidiary cannot be treated as a partnership (in which case the taxable incomes of parent and subsidiary are pooled and there is no tax on intercompany dividends), to the extent that the paying company has not already paid Canadian tax on the income from which the dividends are paid.

This means Alcan will be liable to pay additional tax on dividends from some of its Canadian subsidiaries, for example where the partnership option cannot be used because a subsidiary has a foreign or unwilling minority shareholder and for some reason cannot provide a full tax credit with the dividends it pays to Alcan.

In addition Alcan has a special major problem of its own here which unless rectified can prove extremely damaging. Under the White Paper as it stands Alcan will be forever unable to classify its main operating subsidiary, the Aluminum Company of Canada, as a closely-held corporation in partnership with Alcan and will in consequence be unable to pool the two companies' taxable incomes and will have to pay large amounts of tax on dividends paid to it by the Aluminum Company of Canada. The Aluminum Company of Canada will be classified as a widely-held corporation as although it is 100% owned by the parent Alcan it has redeemable sinking fund preferred shares owned by the public and traded on Canadian stock exchanges. As 25% of its income comes from dividends received from foreign subsidiaries on which foreign but no Canadian tax has been paid it cannot provide a full Canadian tax credit when it pays dividends to its parent Alcan and Alcan will have to pay a considerable amount of additional tax.

It is recommended both that intercompany dividends be exempted from taxation and also that a fully-owned subsidiary with redeemable preferred shares held by the public, like the Aluminum Company of Canada, be classified as closely-held for this purpose and eligible for treatment as a partnership.

There is further detailed discussion of these matters on pages 15-19 in the technical appendix II.

c) if integration is adopted as proposed in the White Paper without the revisions described herein which Alcan seeks, Alcan's effective corporate rate of tax will increase significantly. Although Alcan's Canadian shareholders will receive certain offsetting benefits as a result of integration, its foreign shareholders will not receive these benefits and as a consequence lower after tax profits will reduce the attractiveness of Alcan shares to foreign holders. Such a result will further handicap Alcan's competitive ability to raise money in other countries either as debt or equity.

France introduced an integration scheme in 1967 and in its recent tax treaty with the U.S.A. recognized the difference in treatment as between domestic and foreign shareholders by agreeing to pay U.S. citizens, holding less than a 10% interest in French corporations, cash equivalent to the tax credit allowed to French shareholders. If Canada introduces an integration system the U.S.A. and other countries may request a similar concession from Canada. The granting of such a concession will assist Alcan.

II. <u>The proposed new system of taxes on capital gains</u>

If Canada introduces the taxation of capital gains -- many other industrial countries tax these already -- Alcan feels the system outlined in the White Paper needs to be modified as follows:

a) the proposals will impose capital gains taxes at the full rate that is applied to income except in the case of gains on widely-held Canadian shares. This is not competitive with practice in the U.S.A. and other industrial countries where less tax is imposed. It is recommended that Canada's rates approximate those of the U.S.A. namely that only half of long-term gains be taxed.

b) it is very important that provisions be included so that tax is levied only when the capital gains arising from any transaction have actually been realized. In some cases such as expropriations and reorganizations it may be a considerable time before any gains are realized.

c) the proposals will affect Alcan's employees by taxing capital gains on a deemed realization basis, although no sale or profit has in fact been made. Other countries including the U.S.A. do not tax deemed realizations. Alcan does not favour such taxes. This

question is discussed further below under Section III(b) insofar as it affects the transfer of employees between Canada and other countries.

There is also a detailed general discussion of the taxation of capital gains on pages 25-31 in the technical appendix II.

III. The proposed new system of taxing individuals

To remain competitive Alcan needs to be able to attract and retain competent managerial talent and to be able to transfer personnel quickly and easily between Canada and other countries.

The proposed changes in the White Paper will affect Alcan's competitive position adversely in two main ways:

a) the new individual tax rates and taxable allowances will continue to place a heavier burden of taxation on the middle income groups (those earning between $10,000 and $25,000 p.a., who form the core of general management personnel) than does the U.S.A. A married houseowner with 3 children earning $10,000 p.a. will pay $1329 tax under the White Paper proposals as compared with $1209 in the U.S.A. in 1970 and $1070 in 1973. A similar taxpayer earning $20,000 p.a. will pay $4822 under the White Paper as compared with $2992 in the U.S.A. in 1970 and $2772 in 1973. A table comparing Canadian and U.S. rates is given on pages 40-42 in the technical appendix II.

   Alcan's average factory employee earnings in Canada today are $7800 p.a. If inflation raises these wages in the next few years the average Alcan employee will soon be in the middle income area where Canadian taxes are higher than U.S. taxes and where his marginal rate is at the discouraging level of nearly 30%.

   If Alcan has to pay higher wages and salaries to compensate for these higher Canadian taxes its competitiveness will be adversely affected.

   Alcan must conclude that it will be handicapped if Canadian tax demands and the distribution of its tax load are not adjusted to approximate those of other industrial countries especially the U.S.A.

b) the proposals will impede the transfer of individuals between countries. In particular:

   i) some 500 of Alcan's management employees in Canada today have served Alcan in other countries. The necessary movement of management personnel between Canada and other countries will be impeded by the deemed realization provisions of the capital gains tax proposals (see II(c) above).

Under these proposals any person leaving Canada will have to pay a capital gains tax on the estimated change in value of all his assets (including assets outside Canada) since he bought them or since official valuation day or since he came to Canada. Many international transfers of persons made by Alcan in and out of Canada are on a temporary basis and people eventually move again. Payment of deemed capital gains under these circumstances will be especially onerous.

Alcan does not favour taxation on a deemed realization basis. If such a system is adopted however it is suggested that Canadians who go temporarily to other countries and foreigners who come temporarily to Canada be exempted from the payment of deemed capital gains tax when they leave Canada.

ii) the White Paper proposes to impose a withholding tax on the pensions of members of Canadian pension plans who do not live in Canada when they retire.

Alcan like many other international companies has employees in its Canadian pension plans who are resident in and work in other countries (generally developing countries) pay taxes in these countries and owe no tax obligations to Canada. It is suggested that any Canadian withholding tax on pensions be applied only to pensions arising from service in Canada.

The recommendations made under (i) and (ii) above and other recommendations concerning the taxation of individuals are discussed further on pages 32-42 in the technical appendix II.

IV. <u>The proposed new system of taxing international income</u>

The White Paper introduces new measures aimed at:

1) minimizing tax avoidance through the use of foreign corporations

2) increasing Canadian withholding tax revenues.

As a multinational company Alcan is particularly sensitive to these kinds of tax proposals because they can increase tax costs sharply and administration costs unduly.

1) Minimizing tax avoidance through the use of foreign corporations.

As regards tax avoidance, foreign subsidiaries can be grouped into two broad classes -- companies which carry on an active business and "paper" companies which do not carry on an active business. There are also two kinds of tax avoidance arrangements -- those designed to avoid Canadian tax and those to avoid foreign taxes.

Alcan recommends that Canadian tax reforms in this area concentrate

firstly on Canadian rather than on foreign tax avoidance and secondly on "paper" companies rather than on foreign subsidiaries which carry on an active bona fide business. If these principles are adopted new legislation against tax avoidance can be confined to individuals and closely-held companies inasmuch as existing tax law seems adequate to deal with the avoidance of Canadian taxes by widely-held corporations through the use of "paper" companies and the like.

Alcan is especially concerned in this connection as it has foreign operating subsidiaries in many countries including several engaged in active trading operations in such countries as Switzerland and Hong Kong and a shipping company in Bermuda. Alcan sometimes creates foreign corporations as holding companies owning the stock of other operating companies in a particular area in order to obtain permission to consolidate foreign taxes, to minimize foreign taxes on intercompany dividends and to facilitate the raising of capital. None of these are "paper" companies formed to avoid Canadian tax.

In addition to the general remarks above there are 3 particular aspects of the White Paper proposals which will handicap Alcan. The proposals have been designed to minimize tax avoidance through the use of foreign corporations but as far as Alcan is concerned seem likely to raise its taxes on income from normal business activities.

a) dividends sent by foreign subsidiaries to Canadian parent companies are today not taxable in Canada. The White Paper proposes to exempt from Canadian tax only those foreign dividends coming from countries with which Canada has a treaty. Dividends from non-tax treaty countries will be subject to Canadian tax with an allowance for the corporate and withholding tax that has been paid on them in these countries.

   The effect of the White Paper proposal will be to increase Alcan's tax bill and to put some developing countries at a disadvantage. Some of these countries (Brazil, India and Mexico are 3 main examples) will probably not be willing to make tax treaties for reasons of their own but they do offer tax incentives in order to encourage foreign investment. In these cases the White Paper proposal means that Alcan will not be able to benefit fully from any of these tax incentives and the developing countries' purpose in offering them will be largely frustrated.

   If the taxation of foreign dividends is instituted a possible solution may be for the Canadian government to exempt from tax dividends from certain non-treaty countries or from certain companies in non-treaty countries.

This is discussed in further detail on pages 43-44 in the technical appendix II.

b) the White Paper proposes to tax "passive income" i.e. to tax certain kinds of profits deemed to be diverted to controlled foreign corporations, whether they are distributed to their Canadian owners or not. This measure is to be patterned on similar provisions which exist in the U.S.A. Alcan does not favour this proposal.

There are existing sections of the Canadian Income Tax Act which can deal with this type of tax avoidance by widely-held companies, for example those covering pricing, interest, and artificial transactions.

Furthermore, U.S. experience shows that these new proposals to tax "passive income" are administratively expensive and difficult to operate and seem likely to impede exports by increasing taxes on legitimate export business.

If it is decided to proceed with the new proposals, serious policy problems will arise as they have in the U.S.A. in trying to exclude foreign income arising from normal legitimate business such as Canadian exports, shipping, etc. from the total of "passive income" on which tax is to be levied. These problems are discussed further on pages 44-49 in the technical appendix II.

c) to be exempt from Canadian tax under (a) above, the dividend paying controlled foreign corporation must be 25% owned or more.

U.S./U.K. practices treat as controlled those corporations owned 10% or more, and it is recommended that similar rules be adopted in Canada. Detailed comments on this matter are given on pages 49-51 in the technical appendix II.

2) Changing Canadian withholding taxes.

There are two proposals dealing with withholding taxes which require comment.

a) it is proposed to increase Canadian withholding tax rates on interest and dividends flowing to foreigners. This may increase the rate of interest Alcan has to pay on foreign loans from countries with which Canada has no tax treaty at the time. It is recommended that withholding rates be negotiated at the low rates suggested by OECD and that pending agreement rates in respect of existing obligations be maintained at existing levels.

b) it is proposed to eliminate most or all of the double taxation arising when dividends received from foreign subsidiaries (in all countries, whether Canada has a tax treaty with them or not) are subject to a withholding tax and dividends paid by the receiver to foreign shareholders are subject to a second withholding tax. The elimination of this double taxation under the provisions for the flow-through of foreign withholding taxes will benefit Alcan and its shareholders.

Both (a) and (b) above are discussed further on pages 51-52 in the technical appendix II.

The review above has set out the areas of most concern to Alcan in the White Paper proposals. Certain other matters of concern to Alcan both in the White Paper and in the existing tax system are discussed on pages 53-57 in the technical appendix II.

Conclusions

Some of the White Paper proposals, especially those dealing with domestic intercompany dividends (I (b) above) the taxation of foreign dividends from countries without a tax treaty (IV (a) above) and the taxation of passive income (IV (b) above) will directly increase Alcan's present tax bill by significant amounts.

Other White Paper proposals especially those involving the maintenance of existing corporate tax rates because of integration (I (a) above), the taxing of most capital gains at full rates (II (a) above), the relatively high tax rates to be imposed on many individuals and also on persons leaving Canada (III (a) and (b)), and the general attempt to increase the scope of taxation of international operations of widely-held companies (IV) will have a definite but indirect adverse effect on Alcan as an enterprise.

While Alcan does not quarrel with the proposed adoption of an integrated tax system, the introduction of a capital gains tax and the installation of new measures to minimize tax evasion the overall impact of the White Paper at the level of tax rates suggested will cause serious damage to Alcan. In this brief revisions have been suggested which will remove the adverse effects on Alcan and still leave the framework of the basic White Paper structure intact.

ALCAN ALUMINIUM LIMITED

APPENDIX I

COMMENT ON PROPOSALS FOR TAX REFORM
OF 7 NOVEMBER 1969

FURTHER INFORMATION ON ALCAN ALUMINIUM LIMITED

1) Shares held by country as at 31 December 1969:

	%
Canada	34.7
U.S.A.	55.0
Other	10.3
	100.0

2) Employment by area during 1969:

	Employees		Payroll	
	000	%	$ mill.	%
Canada	19.3	30.8	163.0	51.8
U.S.A.	5.0	8.0	46.6	14.8
Caribbean	9.6	15.4	27.3	8.7
Latin America	6.4	10.2	12.8	4.1
U.K.	7.2	11.5	25.5	8.1
Other Europe	5.0	8.0	18.5	5.9
Asia	6.4	10.2	6.1	1.9
Africa	1.6	2.6	4.3	1.4
Oceania	2.0	3.2	10.3	3.3
	62.5	100.0	314.4	100.0

3) Sales by country during 1969:

	000 tons	%
Canada	151	11.1
U.S.A.	400	29.3
U.K.	189	13.9
E.E.C.	157	11.5
Japan	155	11.4
Other	311	22.8
	1363	100.0

Total consumption of primary aluminum in the free world during 1969 was 8,460,000 tons.

4) Sources of aluminum ingot during 1969 for sale as ingot or conversion into sheets, bars, etc:

	000 tons	%
Production - Canada	946	69.4
Other countries:		
- by subsidiaries	81	5.9
- by affiliates	170	12.5
Purchases from third parties	166	12.2
	1363	100.0

5) Proportion of total sales (including metal from other sources as well as Canada) exported throughout the world during 1968:

	000 tons	%
Total sales	1220	100.0
Exports included above	846	69.3

During 1969 the proportion exported has been roughly the same as in 1968.

As regards Canada, approximately 805,000 tons (or 85%) of the 946,000 tons produced in Canada in 1969 were exported.

6) Canadian taxes paid by Alcan during 1968:

	$ mill.	%
Income taxes - to Canada	33.7	58.5
- to provinces	7.7	13.4
Property taxes	11.4	19.8
Other taxes (sales, education, water rental, etc.)	4.8	8.3
	57.6	100.0

As regards provinces the largest amount - $16.5 million or 28.7% of total taxes - went to Quebec. "Other taxes" exclude Canadian federal sales tax.

Total taxes paid have been higher in 1969 than in 1968.

7) Distribution of total assets (including fixed assets after depreciation) by area as at 31 December 1969:

	$ mill.	%
Canada	895	41.6
U.S.A.	301	14.0
Caribbean (including Guyana)	196	9.1
Latin America	99	4.7
U.K.	165	7.7
Other Europe	225	10.4
India	90	4.2
Other areas	179	8.3
	2150	100.0

8) Source of funded debt by country as at 31 December 1969:

	$ mill.	%
Canada	61	8.8
U.S.A.	398	57.2
U.K.	114	16.4
Other	123	17.6
	696	100.0

9) Comparison of total taxes (Canadian and foreign) paid by Alcan and by the 3 major U.S. aluminum companies - Alcoa, Kaiser, Reynolds - during 1964-68. Alcan and the 3 U.S. companies are the world's 4 largest producers. Alcan "other taxes" exclude Canadian federal sales tax.

	Alcan Annual average Can. $ mill.	3 U.S. companies added together Annual average U.S. $ mill.
Income taxes	56.6	112.0
Property taxes	12.3	26.1
Other taxes	7.1	46.8
	76.1	184.9
Total taxes as % of net sales	8.1%	6.7%

ALCAN ALUMINIUM LIMITED

APPENDIX II

COMMENT ON PROPOSALS FOR TAX REFORM
OF 7 NOVEMBER 1969

TECHNICAL DISCUSSION

I. Integration. Corporations and their shareholders

A. The reduction of corporation tax rates

For competitive reasons it is desirable that the Canadian system be able to accommodate eventual reduction in the corporate rate to the 40%-50% range. Recent trends indicate that countries in the developed/industrial category are increasingly setting their effective tax rates below the 50% level. For example, Norway has recently adopted the German scheme and introduced dividend deductibility which effectively reduces corporate taxes, bringing them more in line with real corporate tax loads in Sweden, Germany and the U.K.

The economic point to a rate reduction, of course, is that the corporation has increased its cash and increased its after-tax income. So long as the money is reinvested in the business, the main objective in the reduced rate of tax is achieved.

If corporate tax rates are reduced below the top personal rates certain tax problems arise:-

1) whether shareholders will leave cash in the corporation which is not needed in the business, i.e. refuse to distribute dividends, in order to avoid paying the additional tax, i.e. the difference between the corporate rate and the top personal rate; and

2) whether the shareholder can sell his shares at a price which will let him realize some of the tax saved in the corporation as personal income after paying capital gains tax.

It is important to recall that the proposals distinguish widely-held companies from closely-held companies because, in an integrated tax system, the consequences to shareholders of establishing a corporate rate lower than the top marginal personal rate of tax are different depending on whether one is a shareholder or a closely-held or a widely-held corporation. The differences are noted on Table 1 on page 23 of this appendix at the end of this section.

In the case of widely-held companies, a reduction in corporation tax payable produces a reduction in creditable tax allowed to

shareholders which may lead to reduced after-tax yields to Canadian shareholders because an off-setting cash dividend increase will not necessarily follow on a reduction in corporate tax payments (i.e. a dividend increase equal to approximately half the corporate tax reduction will be necessary to maintain the after-tax yield to taxable Canadian shareholders). In theory, widely-held corporation shares eventually can be sold at a price reflecting an increase in the corporation's retained earnings due to the tax reduction so that cash more or less equal to the tax saving can be realized by the shareholder subject to a lower capital gains tax.

However, it is suggested that no special rules are required to facilitate tax rate reduction in the case of widely-held corporations because such corporations are more likely to base dividends on market and performance considerations than on tax considerations alone. Widely-held shares are changing hands all the time, share prices cannot be effectively controlled to ensure realization of retained earnings as a capital gain and the corporate management has a strong interest in a regular dividend to foster its reputation in financial circles.

Thus, although a corporate tax rate reduction in a widely-held company can, over a long period of time, be realized on favourable terms by a Canadian resident shareholder in an integrated tax system, it looks as if in practice this is unlikely to make it difficult to reduce the corporate tax rate because such shareholders cannot plan in advance to take advantage of these things.

With respect to closely-held companies there may be some increased likelihood that retaining cash in the company in excess of immediate business needs can lead to this money being converted to personal use. While such actions are much less common than is popularly imagined, the existing tax rules seem adequate to minimize tax avoidance through the conversion of corporate assets to personal benefit.

If the White Paper proposal to tax gains on the sale of shares of closely-held companies at full rates is adopted, there is no way a shareholder can realize the corporate tax saving via capital gains. However, if, as recommended in Alcan's brief, capital gains are taxed at effectively 25% (or half gains at full rates) then a shareholder of a closely-held company can save tax by leaving cash attributable to a corporate rate reduction in the closely-held corporation and selling shares if effective corporate tax rates are low also (say 30%) as a result of a low corporate rate, depletion, accelerated depreciation, etc. See Table 1 on page 23 of this appendix. Since this kind of a situation can be controlled by individual shareholders it is suggested the tax avoidance aspect can be protected by treating the proceeds of sale of closely-held corporation shares as a receipt of dividends to the extent of post-1971 undistributed income, subject to tax as a dividend with only

the balance of proceeds entitled to treatment under the more favourable capital gains rules. If this is done it should be possible to reduce the corporate rate below the top personal marginal rate without a serious leakage in the tax system.

This is an area of taxation in which practical judgment is required to devise a policy which balances and accommodates the need for integrity and consistency in assessing taxes against the need for competitiveness of commercial and industrial concerns -- particularly those affected by international trade.

B. The taxation of domestic intercompany dividends

Taxation of dividends paid by Canadian subsidiaries to Canadian parent companies on the gross-up and credit basis proposed in the White Paper will be avoided whenever possible because the disadvantages will cause such groups to make every effort to obtain the partnership option.

Where the partnership option is not available (because the subsidiary is deemed widely-held, or either the share structure, different fiscal year ends of the partners, or non-resident status of a partner prevent electing partnership), it is proposed to tax dividends paid by one Canadian company to another on the gross-up and credit basis at a rate of 50% in the case of dividends from closely-held companies and at a rate of 33-1/3% on dividends from widely-held companies. Alcan, and other Canadian companies which have elected to operate in Canada through subsidiaries, will object to this proposal because it will inevitably result in unjustified increased tax payments. The extra tax payments will arise when the dividend paying company cannot supply a tax credit because it is (or has been) expending and investing in depreciable property with fast write-off privileges or depletion allowances offered as an incentive, or has large foreign dividend revenues.

Added taxes apparently will also be attracted to dividends being paid out of the pre-implementation surplus whether or not the partnership option applies.

Alcan recommends retention of the existing system exempting dividends paid by one corporation to another for the following reasons:

1) The government has proposed to bring into taxable income dividends from Canadian companies mainly to facilitate the concept of an integrated system.

   Alcan feels however, that other considerations than the creation of a logical integration tax system are important and that these justify the retention of the existing structure

whereby dividends are exempt when paid by one Canadian company to another. Corporation tax is paid on operating income and such income should not be taxed again until, net of all expenses, it is distributed as a dividend to an individual or to an entity which is not in a control position by virtue of ownership of a large block of shares in the corporation or group which originally earned the income.

2) Exemption insures that tax will not be paid on income passing between corporations where the original earned income was subject to a low rate of tax due to deliberate government policy to foster that activity or the related investment by special depreciation allowances. The difference between this low tax rate and the maximum corporate rate should not be extracted as tax so long as the funds stay in the corporate chain of ownership. To do otherwise will provoke a mass of corporate reorganizations in Canada and minimize opportunities for large conglomerates to spin off small and middle size diversifying ventures.

3) In a system where the shareholder and corporation taxes are integrated, intercompany dividend exemption is really tax deferral and not tax exemption since the difference in tax will ultimately be paid when the funds are distributed as dividends.

4) Tax paid by one widely-held corporation on dividend income from another widely-held corporation is in a special category and treated as fully creditable to the individual Canadian shareholder, whereas tax paid by a widely-held corporation on dividends from a closely-held corporation will be merely half creditable. In either case however, the corporation is applying its assets to pre-pay some part or all of shareholder's tax. In some people's minds it will be a question whether this is sound practice particularly since some of these tax payments will in fact not be used as tax credits by the shareholders because they will become staledated or the shareholder is not entitled to tax credits (i.e. a non-resident or tax-exempt institution).

5) Alcan's Canadian ownership has run from 35% to 40% of total shares outstanding. Thus about 60% of Alcan's shareholders are non-resident and will not benefit from integration as presently proposed. Canadian tax-exempt institutions own many of Alcan's shares and they likewise will not benefit from integration. Additional taxes paid by Alcan on inter-company dividends will reduce the attractiveness to non-resident and Canadian tax-exempt shareholders of Alcan as an investment. As a multinational corporation this is not in Alcan's best interest.

6) The U.K., U.S.A. and Germany, three principal industrial nations, do not charge income tax on intercompany dividends where requisite share ownership exists (75% in the case of U.K. and Germany, 80% in the case of U.S.A.). Where the required percentage ownership is not present, tax on such dividends is recouped by credit or is set at a very low level (about 7% in the case of the U.S.A.). Canada should not be materially different.

To meet the requirements of integration it is recommended appropriate rules be framed to provide "a more exact method of passing credit for Canadian corporate tax through a chain of corporations" (paragraph 4.55), whereby the paying company will allocate the dividend first to foreign income, then to domestic post-1970 income, then to pre-1971 surplus. Creditable foreign and domestic tax will be computed. All of these data will be reflected in information returns filed with the tax authorities. Appropriate entries will be required to be made in a tax balance sheet which will be the basis for tax obligations in respect of dividends paid out by the recipient.

The arguments given in White Paper paragraph 4.53 and following for doing away with the present exemption of intercompany dividends in favour of the proposed scheme of gross-up and credit are not sound, for the following reasons:

a) The objection relating to tax postponement of personal income tax by use of personal holding companies (paragraph 4.53) speaks of defects in the statute (section 67). It looks as if the cure should be done there without upsetting larger policy considerations. It is not a general argument for dispensing with exemption. A government which is prepared to tax foreign "passive" income with its many complications (see paragraphs 6.20 and 6.21 of the White Paper) may be presumed capable of resolving the picayune difficulties mentioned here -- namely, defining a "personal corporation" and allocating income among several classes of shares.

b) The second argument (paragraph 4.54) objects to a 20% dividend tax credit being given in respect of Canadian dividends derived from Canadian tax-exempt foreign income sources. One can object to a 20% credit in respect of such amounts in the hands of a Canadian individual taxpayer, but this is not an argument against <u>intercompany</u> dividends being free of tax. This is a problem of mechanics not policy.

c) The final argument (paragraph 4.55 of the White Paper) is that otherwise corporate shareholders will avoid tax by purchasing control of companies, declaring maximum possible tax-free dividends out of the subsidiary and then selling the shares for an artificial loss. The answers to this objection are or can be built into the proposed system as follows:

i) Dividends attributed to pre-1971 surplus will reduce the cost basis of the shares (paragraph 4.78).

ii) Dividends attributed to "pre-acquisition post-1970" earnings, to the extent covered by creditable tax, will be included in the tax-paid surplus of the recipient and if not paid out within the prescribed period will be lost forever as "staledated". However, a rule such as that proposed at paragraph 6.19 for foreign subsidiaries will be appropriate, i.e. reduce the deductible loss by reference to dividends received from the corporation out of what is essentially purchased surplus or capital.

iii) Dividends paid out in excess of undistributed income should be treated as a return of capital and likewise reduce the cost basis of shares. For example, if the dividend is in the form of assets, the market value should be taken into account to reduce the tax basis of the shares in order to eliminate an artificial loss.

Thus the new proposals set out a milieu in which there should be no way to strip a corporation of its assets to manipulate an artificial loss without making applicable offsetting adjustments in share costs.

Definition of widely-held corporations

The Aluminum Company of Canada is the largest subsidiary of the Alcan group and has a large income derived as dividends from controlled foreign corporations mainly located in the Caribbean and engaged in the production of bauxite and alumina. In 1967 and 1968 these foreign dividends accounted for 25% or more of the Aluminum Company's income before Canadian taxes. The presence of these companies in the Aluminum Company's balance sheet is a material factor in the security of the long-term debt of the Aluminum Company which is in the order of Can.$450 millions.

The Aluminum Company of Canada has two issues of redeemable, non-participating preferred stock duly registered on Canadian stock exchanges, whereas all of this company's voting common stock is owned by Alcan Aluminium Limited. In normal course, the preferred issues will be fully redeemed by the late 1970's. By virtue of the White Paper proposal in paragraph 4.43, the Aluminum Company will be deemed to be widely-held in perpetuity since its preferred shares were outstanding on 7 November 1969. As a consequence, the Aluminum Company will not be entitled to pool its taxable income with Alcan Aluminium and other Canadian subsidiaries of Alcan Aluminium.

Furthermore, the dividends of the Aluminum Company will be brought into the taxable income of Alcan Aluminium on the gross-up and tax credit basis with significant net tax liabilities since these dividends tend to be large and tax will be attracted to the foreign income and

accumulated surplus content of the dividend. If the White Paper had been implemented on 31 December 1966 it is estimated that additional tax liabilities arising on these accounts would have been $10.5 millions in 1967 and $4.3 millions in 1968.

It is of major importance to the Alcan group to aggregate the income of its Canadian companies for Canadian tax purposes to offset losses against profits. Alcan assumes that the government's intention here is purely to make the integration policy work and that it does not intend as a matter of policy to extract meaningful amounts of tax on dividends between affiliated Canadian companies. It feels this result is a fortuitious consequence of merely technical rules which do not go to the true merits of the reform proposals themselves.

Alcan recommends that a corporation be allowed to retain the closely-held status despite the existence of a listed issue of preferred stock if all of the common stock is owned by a single widely-held Canadian corporation, and if the parent company elects to treat it as closely-held. Possibly such a listed preferred issue should be redeemable, non-participating, and carry a sinking fund, thus making it relatively more like a debt issue. A "grandfather" clause to limit such election to existing situations of this sort can also be considered.

In such cases, the subsidiary company will be permitted to elect the partnership option as a 100% participation with the parent. The listed preferred shares will be treated as shares of the parent for tax purposes. Dividends on the preferred shares will be tax creditable pari passu with the parent's shares and will be entitled to similar capital gains tax status.

C. Integration - international aspects

There are several basic problems with the integration proposal from the international point of view which concern a multinational company such as Alcan.

The principal problem is that integration increases the differences in the yield as between resident and non-resident shareholders on most Canadian shares from results prevailing under present law by increasing the aggregate tax credit available to the Canadian shareholder. See Table 2 on page 24 of this appendix at the end of this section.

It is in Alcan's interest to maintain a stable market for its shares in the major countries in which it operates. To this end Alcan has registered its stock for trading in numerous foreign exchanges. The integration proposal is quite likely to disrupt existing patterns of trading by virtue of a tax premium on the shares in the Canadian markets which premium will vary unpredictably based on short-term tax considerations. The White Paper proposal is superior to the Royal Commission integration proposal in this regard since the tax premium for Canadians has been scaled down. But some unstabilizing impact on share price

performance remains.

France, which in 1967 adopted an integrated tax credit regime similar to that proposed for Canada, has recently agreed with the United States to give U.S. shareholders holding less than a 10% interest in French corporations cash equal to the tax credit (avoir fiscal) allowed to French shareholders in such corporations.

The U.S.A. may make a similar request of Canada. It looks as if the European Economic Community in its effort to harmonize taxes among its six members is considering such a scheme of mutually exchangeable credits. Italy apparently has on the order paper of its parliament a shareholder tax-credit scheme similar to that of France.

All of these factors suggest that if Canada takes the course proposed in the White Paper it will expose itself to pressure from various quarters to extend the benefit of integration to non-resident portfolio shareholders (less than 10%). In the interest of equalizing after-tax returns to all its shareholders everywhere, Alcan is in favour of Canada granting such a concession. Exposure to this risk is not presented under the existing system which makes no pretence that any part of the corporate tax is paid on behalf of shareholders.

Finally, since tax credits for Canadian shareholders are limited to the amounts of tax paid by the Canadian corporation conflicts of interest can arise between resident and non-resident shareholders. If tax payments in a particular year are inadequate to provide a full tax credit, it is possible pressure may arise for example from resident shareholders to defer capital cost allowance deductions to generate additional tax payments. If tax payments have been in excess of those required to provide fully creditable dividends to Canadians and the excess is about to expire as creditable tax, it is possible that resident shareholders may in some cases seek extra cash dividends or a stock dividend to utilize the credits. This is something which the non-resident shareholders may find is not in their best interests and which the corporation may feel is not consistent with the best interests of the enterprise.

Alcan does not view with any enthusiasm the adoption of a Canadian tax system which will put the executives and directors of a corporation in a position of facing conflicts of interest such as these.

D. <u>Integration - general technical aspects</u>

1) <u>Widely-held and closely-held corporations distinguished</u>

The proposals at paragraph 4.43 provide that a corporation which was widely-held on 7 November 1969 or subsequently became widely-held shall remain widely-held forever even though the shareholders may prefer it to become closely-held. Such strict rules will work

a hardship on many corporations. Provisions to permit changes in status should be provided for in the legislation.

2) Partnership option - qualifications

The qualification rules are not unreasonable so long as groups of companies are allowed a period of time to comply, for example, by buying-out minority interests presently held by non-residents or re-arranging fiscal year-ends so that the group is on the same accounting basis, or consolidating several classes of shares into one class.

Furthermore, it should be clear that companies acquired in the future may elect the partnership option upon compliance with reasonable rules for the protection of government revenue.

3) Partnership option - intercompany profit

Alcan has Canadian subsidiaries which generate electric power, provide rail and water transportation, fabricate metal, etc. The activities of these subsidiaries do not produce income in the economic sense until a product or service is sold to a third party. However, intercompany "sales" create artificial taxable income as long as a year in advance of a real sale to third parties. Consolidated returns (as in the U.S.A.) permit the elimination of such artificial profits. It is not clear that the partnership option will permit accounting entries to be made to eliminate these artificial profits for tax purposes on the same basis as such entries are made in computing the consolidated accounts of any group of companies for reporting results to shareholders. Such an arrangement should be provided as a competitive factor vis-a-vis the U.S.A.

4) Prescribed time limit

Under the White Paper proposals taxed earnings must be distributed or capitalized within 2-1/2 years in order for the tax to be creditable. This is too short. Business needs will prevent cash distributions at this rate in many cases and stock dividends will be impractical for some companies, such as Alcan, because of international aspects, (i.e. Canadian non-resident withholding tax and possible foreign tax obligations) or because of adverse financial consequences (i.e. too much dilution). A seven to ten year time limit will be better because by this time there will be reasonable assurance the cash has been permanently invested in the business and a capitalization or foregoing of the credit will work real injury while minimizing tax avoidance.

5) Transition problems

Paragraph 4.79 of the White Paper provides that part of the tax

paid by non-option closely-held corporations will be treated as non-creditable until an amount of tax has been treated as non-creditable equal to the amount of tax that would have been paid or "recaptured" if the assets (depreciable property, goodwill, inventory) had been sold at a price equal to that which the taxpayer used in valuing the closely-held shares on valuation date.

This proposal can be injurious in principle (because the fisc is getting its tax bite long before a realization of the relevant values in the shares) in the case of assets which are of great value to the owner, but which in fact are not saleable except to someone buying out the entire business as a going concern. Substantial injury to integrated businesses (through added taxes) will be minimized by this rule, only if the income on which tax in non-creditable is added to pre-implementation surplus for special treatment or other arrangements are provided in line with suggestions above to defer tax on intercompany dividends.

At paragraph 4.78, it is proposed that a special 15% tax be levied on dividends paid out of undistributed income on hand at the commencement of the new system. Since a Canadian resident shareholder is to receive a dividend out of such undistributed income free of further tax, any special tax should be for his account when paid out. To assure fair dealing regarding Alcan's non-resident shareholders, the law should make it explicit that the special tax is levied only on the relevant amounts distributed to resident shareholders and is recoverable from them by means of tax withholding. That is to say, the corporation should not suffer the tax because this shifts a pro rata part of the cost to non-residents who do not benefit from the expenditure. This may provoke questions of director liability under the relevant Companies Acts. This is a further reason why this type of tax should be deferred, insofar as subsidiaries are concerned, and imposed only at the top.

Treaty considerations will or should permit only one withholding on non-residents' share of such income. Conflict with the "flow through" proposal for foreign withholding tax also seems possible if non-resident withholding tax cannot be deducted from that portion of a dividend deemed to be from this source.

Canadian tax-exempt entities will also find it difficult to accept a deduction from their dividend in respect of a special 15% tax on pre-implementation surplus.

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TABLE 1

Effect of corporate tax rate reduction on shareholders under integration comparing realization as dividend versus realization as capital gains

	Closely-held corporation			Widely-held corporation	
	50% Rate	40% Rate	30% Rate	50% Rate	40% Rate
Corporation income					
Pre-tax income	$200	$200	$200	$200	$200
Taxes	100	80	60	100	80
Net income	100	120	140	100	120
Case I - Net income realized as dividend					
Grossed-up dividend	200	200	200	150	160
Tax @ 50%	100	100	100	75	80
Credit	100	80	60	50	40
Net tax	-0-	(20)	(40)	(25)	(40)
Net dividend	100	100	100	75	80
Case II - Net income realized as capital gain per White Paper					
Capital gain	100	120	140	100	120
Taxable gain	100	120	140	50	60
Tax @ 50%	(50)	(60)	(70)	(25)	(30)
Net gain	$ 50	$ 60	$ 70	$ 75	$ 90
Advantage versus dividend	$(50)	$(40)	$(30)	-0-	$ 10
Case III - Net income realized as capital gain assuming only half gain taxed in all cases					
Proceeds	100	120	140	100	120
Taxable gain	50	60	70	50	60
Tax @ 50%	(25)	(30)	(35)	(25)	(30)
Net gain	75	90	105	75	90
Advantage versus dividend	$(25)	$(10)	$ 5	-0-	$ 10

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TABLE 2

Comparison of yield to resident and non-resident shareholders
under present and proposed White Paper rules
(All figures dollars per share)

	Resident Shareholder		Non-resident**	
	Present	Proposed	Present	Proposed
Case I - All Canadian source corporate income*				
Dividend	$1.50	$1.50	$1.50	$1.50
Gross-up	-	.75	-	-
Taxable amount	1.50	2.25	1.50	1.50
Tax @ 50%	.75	1.12	.75***	.75***
Credit	.30	.75	-	-
Net tax	.45	.37	.75	.75
Yield	1.05	1.13	.75	.75
Change	7.5%+		Nil	
Case II - 40% Foreign dividend source corporate income*				
Dividend	$1.50	$1.50	$1.50	$1.50
Withholding tax	-	.05	.15	.15
Gross-up	-	.68	-	-
Taxable amount	1.50	2.18 X	1.50	1.50
Tax @ 50%	.75	1.09	.75	.75
Credit	.30	.73 Y	-	-
Net tax	.45	.36	.75	.75
Yield	1.05	1.09	.75	.75
Change	3.8%+		Nil	

*Assumptions:

Case I

Pre-tax income	$5.00
Tax	2.00
Net after tax	3.00
Creditable tax	1.00

Case II

	Domestic	Foreign	Total
Pre-tax income	4.00	1.00	5.00
Tax	2.00	.40	2.40
Dividend withholding tax	-	.05	.05
Net after tax	2.00	.55	2.55
Creditable tax	1.00	.05	1.05

**Assume foreign personal tax rate same as Canada.

***Includes 10% Canadian withholding tax.

X 1.50 minus .05(foreign withholding tax flow-through) x 150% (gross-up) = $2.18.

Y 2.18 minus 1.45 - $ .73.

II. The taxation of capital gains

A. The rate of capital gains tax

As stated in the main brief Alcan recommends that only half the amount of all long-term gains and losses be brought into taxable income as realized. Application of this and related recommendations to the various categories of capital assets is set out below.

1) Investments other than shares

The significance of a capital gains tax on bonds and similar forms of indebtedness will be adequately covered by others. However, it does seem to be doubtful wisdom to apply a full capital gains tax to such assets at the present time in view of the weak state of the bond market.

2) Shares of closely-held Canadian companies

It is recommended that only half the gain or loss realized on sale of shares in closely-held Canadian corporations be included in taxable income.

The proposal at paragraphs 3.31 and 4.33 of the White Paper to treat the entire amount of gains and losses on closely-held companies as ordinary income is explained as necessary in order to produce a "balanced" system, to remove advantages in receiving income as share gains rather than as dividends and to equalize the weight of tax as between incorporated and unincorporated business.

a) Affiliated groups of corporations

In the context of large corporations with foreign shareholders and many subsidiaries, these arguments are specious. For example, it is proposed to fully tax gains realized by a corporation on the sale of shares in a closely-held subsidiary unless a roll-over provision is applicable. A full tax on the gain does not achieve "balance" since the dividends in principle should be tax exempt to the corporation. So far as equality is concerned, there is little evidence that the matter of competition between incorporated and unincorporated business constitutes a realistic economic problem. In any event there is nothing to prevent unincorporated businesses from incorporating to take advantage of any discrepancy from a tax point of view.

German, French, U.S. and Japanese laws do not impose any material amount of tax on gains arising from the sale of shares of substantially controlled subsidiaries. Such a tax will prove to be a great disadvantage to the Canadian

effort to promote economic growth through rationalization and establishment of larger, more economic units. It is not competitive.

Sales of domestic or foreign controlled corporation shares are not made necessarily with a view to profit in the same sense as sales of portfolio shares. Such proceeds stay in the business, do not ordinarily flow out in dividends and frequently are not treated as a profit or loss item in measuring earnings. In fact, regulatory bodies such as the SEC in the U.S.A. are tending to require exclusion of such unusual items of income from reported earnings in the interest of more accurage reporting of results to investors.

Thus, there is no real increase in disposable income in the tax sense, but merely a change in application of capital which should attract a low rate of tax at most.

To the extent capital gains are taken into book income of the parent company and available for distribution, the government will recoup any shortfall in the tax payments on the portion distributable to resident shareholders by virtue of the fact that such gains will not generate the normal amount of creditable tax. By treating dividends paid-out by a subsidiary in excess of undistributed income as a return of capital reducing the tax basis or value of the shares, opportunities to create artificial tax losses on such shares will be eliminated.

b) Corporations controlled by individuals

In the context of closely-held corporations controlled by an individual or a family, the capital gains tax will be essentially a tax on goodwill and inflation values since the shareholders will integrate earnings by option, capitalization or dividends (unless the personal top rate of tax remains materially above 50%). A full rate of tax on the realized capital gains of controlling shareholders is simply going to discourage them from converting the company to a widely-held corporation. This is bad policy. A tax regime in which such gains are taxed on only half the amount will avoid such a lock-in.

In order not to permit an individual controlling taxpayer to convert taxable income into a capital gain taxed at lower rates (i.e. the "balance" problem), it should be possible to devise a capital gains tax which treats the first proceeds of sale as a distribution of post-acquisition surplus computed on the tax basis, subject to applicable tax credit, and the balance of proceeds, less tax basis,

as a capital gain subject to tax at a lower rate. Using surplus computed on the tax basis will avoid immediate recapture of capital cost allowance deductions in excess of book depreciation reserve, and it should achieve the policy objective of "balance".

With respect to the "equality" problem, Canadian closely-held corporations are not in fact in competition with the 400,000 unincorporated businesses in a meaningful economic sense. If there were much involved, the latter would incorporate to get the benefit of existing rules. This "equality" argument is not significant enough to justify the proposed treatment of gains from this sector which presents the disadvantages mentioned above.

3) Shares of controlled foreign corporations

The proposal to include in taxable income the full amount of gains or losses on the sale of shares of controlled foreign corporations is not competitive in the international context. Alcan's principal competitors, who are in the U.S.A. and France, are not subject to tax on such gains at anywhere near 50% rates.

A full gains tax on sales of foreign subsidiaries is discriminatory because it will in great degree be a tax on retained earnings which would have been exempt if remitted as dividends. Frequently, dividends are restricted by law or regulation to a percent of registered capital (as in U.K., Norway, Brazil, and other exchange-conscious countries). In other countries for other reasons, the retained earnings of subsidiaries are not at the free disposition of the Canadian parent in the same way they are in the case of Canadian subsidiaries. A less than full rate of tax compensates in some measure for the fact that retained earnings will in fact be taxed under the proposals.

A capital gains tax such as proposed will cause sellers to attempt where possible a total distribution or capitalization of surplus in anticipation of sale in order to minimize Canadian tax. These procedures will inevitably entail substantial withholding, stamp and capital taxes in the foreign countries which can be avoided if the Canadian rate of tax is lower.

4) Shares of widely-held companies

The proposal to tax Canadian resident individuals on half their share gains on widely-held companies is in the international sense competitive. The five year re-valuation proposal presents problems however. Taxation of unrealized capital gains in this manner appears inappropriate particularly in view of the high estate and gift tax rates enacted in 1969 (now effectively 50% on values in excess of $300,000 before provincial

and other credits). Taking the new gift and estate tax structure into account the right tax policy seems to be to impose capital gains tax only on actual realizations, to have no deemed realization on passage of title by gift or bequest, but to require the recipient to take the donor's tax basis in assets acquired by gift or bequest.

At paragraph 4.59 of the White Paper it is provided that a widely-held Canadian corporation realizing a gain or loss on the sale of shares in another widely-held Canadian corporation will recognize the amount of gain or loss in full as taxable income, but will apply a special tax rate of 33-1/3% to such amounts. For all the reasons indicated in section II A 2(a) above (pages 25-26) and in section I C above (pages 19-20) dealing with certain international aspects of tax reform it is suggested that a uniform ruling of taxing gains and losses at 25% as realized is to be preferred.

B. The payment of tax only when capital gains have been realized

1) Roll-overs

a) Forced realizations

At paragraph 3.44 of the White Paper it is proposed that where the taxpayer uses the whole of the proceeds from a forced realization to purchase similar property within a year of receipt, any capital gain will be treated as a reduction in cost of the new property.

These aspects require comment:

i) "Whole of the proceeds". In many forced realizations the proceeds will be received in installments. Arrangement is required for an escrowing of such funds for tax purposes until there is sufficient in hand to make a qualifying investment in view of the circumstances of the business.

ii) "Similar property". Both in the foreign and the Canadian context a very broad definition is required for this term, in order to ensure that tax is deferred so long as taxpayers reinvest the proceeds of a business expropriation in other business property. Frequently the purpose of expropriation is to eliminate private participation in a particular line of business so that "similar" property does not exist. Expropriation or forced sale of shares will require a "see through" rule so that investment can be made, as nearly as possible, in similar kinds of underlying assets.

iii) "Within a year of receipt". Alcan is concerned primarily with the tax consequences of large expropriations, particularly those involving foreign shares. A longer time than a year is required to soundly invest big money. An area of administrative discretion is required here to permit tax deferral to apply while a sound selection of an appropriate reinvestment is made.

iv) "Forced realization" in the context of foreign assets will require a definition which permits political duress, threat and harassment to be taken into account as tantamount for tax purposes to expropriation.

b) Corporate reorganizations and mergers

i) The proposal for roll-over upon transfer of assets to a controlled corporation appears reasonable in general. However, the exclusion from tax deferral of transfers of shares in foreign corporations should be modified to allow such transfers on a roll-over basis where the Minister is satisfied tax avoidance is not the principal purpose of the transaction. Alcan's foreign subsidiaries are the frequent object of reorganizations, mergers, and swaps. There does not seem to be any prospect for Canadian tax avoidance in these re-arrangements and they are vital to the growth and success of the corporation. It will be important to exempt any theoretical accounting gains on such transactions from Canadian tax if the needed rationalization and strengthening of Alcan's foreign marketing efforts is not to be hindered.

ii) The proposal to permit a roll-over basis in the case of transfers of assets upon the winding-up of a closely-held Canadian corporation is sound.

iii) The exemption from gains tax in the case of stock-splits is sound.

c) Dispositions of business assets - U.K. provisions

When the U.K. adopted a capital gains tax in 1965 it introduced provisions to defer or remove any undue effects such a tax might have on transfers of business assets. Transfers of assets between companies which are members of a group are allowed a "roll-over", i.e. tax is deferred. Furthermore, tax is also deferred on gains realized on the disposal of business assets where the proceeds of sale are wholly reinvested in a new asset of the same class for use

in the business within twelve months or such extended time as the Board of Inland Revenue will allow.

It is recommended that similar rules, which appear to be more generous than the White Paper proposals in respect of tax deferral on transfers of business assets, be considered for Canada.

2) Gifts and bequests

The White Paper proposes to tax an accrued gain to the donor if he makes an inter vivos gift of appreciated property. However, bequests will not be subject to gains tax, the legatee taking the tax basis of the testator.

It is suggested in section II A (4) above (pages 27-28) that capital gains tax be imposed only on actual realization and that tax not be imposed upon the accrual increase in value of gifts and bequests particularly in view of the very high gift and estate tax rates established in 1969.

C. Taxing capital gains on a deemed realization basis

The proposal at paragraph 3.40 to require emigrants from Canada to pay tax on accrued gains will detract materially from Alcan's management recruiting efforts.

Any attempt to tax deemed realizations will inevitably prevent consideration of employment in Canada by a large element of the best foreign managerial talent. Alcan, a multinational company, with highly compensated managerial talent recruited and rising to top jobs in all the continents of the earth, needs to bring these people to Canada for service at some point in their careers.

If some form of deemed realization tax on departure from Canada is adopted, it is recommended (1) that a minimum exemption be provided (2) that the tax apply only to citizens or to the Canadian-situs assets of aliens whose continuous residence in Canada is so long as to substantially equate citizenship (i.e. twenty years) and (3) that appropriate exemption procedures be established for Canadian citizens temporarily leaving the country on an assignment by a Canadian employer and for foreign citizens accepting employment in Canada on a temporary basis.

D. The taxation of capital gains - other matters

1) Principal residence

The proposal at paragraph 3.20 of the White Paper to allow a taxpayer a "roll-over" on sale of a principal residence only in connection with a change in job is entirely too

restrictive.

Any change in a principal residence should be allowed a roll-over. The roll-over should also be given a longer time period for operation, i.e. more time, at least 2 years, should be allowed in which to purchase the new principal residence or to sell the old.

2) Valuation

At paragraph 3.15 of the White Paper it is proposed not to tax gains accrued under the present system, but to permit taxpayers to establish the tax value of capital assets ("tax basis") at value on valuation day.

The U.S.A., when introducing capital gains tax, provided that a taxpayer's tax basis was the higher of cost or market on valuation day for all purposes. The U.K., in its 1965 capital gains legislation, provided that a taxpayer could use cost when higher than market on 1 April 1965 at least to the extent of sales proceeds realized, i.e. he could not create a tax loss out of a cost higher than his tax basis, but in no case would he pay tax on any difference between his cost and his tax basis realized as sales price.

This U.K. principle involves elements of fundamental justice and it is recommended that Canada adopts a similar rule. Apparently, the Government is disposed to this view in respect of bonds, as the Minister has advised that in respect of bonds which on valuation day are worth less than their original cost, taxpayers will not be taxed on that difference in the event the price later rises. It is strongly recommended that this rule be extended to all capital assets.

III. The taxation of individuals

A. Rates of tax with special reference to the problems of middle income groups

Tables 3, 4, and 5 at the end of this section show existing personal income tax rates in Canada, those proposed by the White Paper, and those just adopted in the United States. There are significant differences between the three.

Note three examples illustrating the differences (in each case concerning a married man with three children aged 16 to 21 and other allowances as indicated on Tables 3, 4, and 5, and with social security contributions included in taxes):

	Present tax			Future tax		
Gross income	Canadian tax 1970	U.S. tax 1970	Difference	Canadian tax (White Paper) 1975	U.S. tax 1973	Difference
$ 7,000	$ 628	$ 729	$ 101	$ 505	$ 619	$ 114
15,000	2,803	2,037	(766)	2,965	1,859	(1,106)
25,000	6,889	4,074	(2,815)	6,942	3,809	(3,133)

The above comparisons are based on salaried income only. Income from sources such as interest, capital gains and real estate rentals tends to receive a more favourable tax treatment in the United States, particularly for persons in the middle income brackets, whereas income from dividends of domestic corporations of the respective countries is materially more favourably treated in Canada at all tax levels.

These tax differentials at the higher levels are too great to be supported without serious effects on the economy of Canada. Such substantial differences will make it attractive to highly educated and trained Canadians to accept employment in the United States. To meet this phenonomen, particularly at the university recruiting stages, Canadian employers will have to offer higher starting salaries and incur the "push" effect this will have throughout their salary structures, with adverse competitive effects.

In principle the Government's proposal to increase personal exemptions is reasonable but it is suggested the increases be introduced by stages over a four-year period, much as is being done in the United States, to avoid inflationary effects and to minimize the immediate effect on government revenues. The minimized effect on revenues should also leave room for the government to make appropriate downward adjustment of individual tax rates which are too high.

In addition to reducing the rates consideration should also be given to increasing the scope of present deductions and introducing new ones to modify the progressivity of the rate table.

Few of the exemptions and deductions proposed by the White Paper increase beyond the levels allowed for low incomes; where some continuing increase is permitted, for example pension contributions, there is usually a fixed dollar limitation beyond which nothing can be deducted. A single individual with no dependents is entitled to the following exemptions and deductions (references are given to paragraphs in the White Paper):

	Estimated annual earnings		
	$5,000.00	$6,000.00	$7,000.00
(1) Single status (2.4)..................	1,500.00	1,400.00	1,400.00
(2) Employment expenses (2.10)...........	150.00	150.00	150.00
(3) Unemployment insurance contributions.. (2.22)	65.04	72.72	72.72
(4) Canada pension plan contributions - max.	79.20	84.60	84.60
(5) Registered retirement plan contributions 6% on estimated earnings.............	300.00	360.00	420.00
(6) Estimated annual contribution to an extended medical insurance plan.......	60.00	72.00	84.00
(7) Charitable donations.................	100.00	100.00	100.00
	$2,154.24	$2,239.32	$2,311.32

(It is possible to have further deductions for educational expenses, medical expenses not reimbursed exceeding 3% of income, etc.)

As suggested immediately below in sections B to E, increasing the scope of deductions will produce a more appropriate curve of actual tax paid in relation to income and will provide a more equitable rate structure at all levels.

Government should see its way clear to give personal tax relief <u>now</u> at all levels.

B. Personal allowances and deductions

The proposed deductions from personal income suggested by the Government as regards the change in exemptions for dependents having income of their own of $950 or more per year (see paragraph 2.6 of the White Paper) the deduction for costs incurred by working parents for care of their children (in paragraphs 2.7 - 2.9) the allowances for employment expenses covered by paragraphs 2.10 - 2.15, the deduction of unemployment contributions (paragraph 2.14) and the proposals for deduction of expenses incurred in moving from

one job to another (paragraph 2.15) are reasonable proposals.

The inclusion in taxable income of unemployment insurance benefits (paragraph 2.22) fellowships, scholarships, bursaries, and research grants where such awards go to post-graduate students and research workers and are in effect remuneration (paragraph 2.24) and allowances paid under the Adult Occupational Training Act (paragraph 2.25) are logical.

The wisdom of including scholarships and bursaries in the tax base where the awards go to students engaged in undergraduate studies (paragraph 2.24) is questionable. Bursaries in particular are granted to help meet living costs and taxation of such amounts is likely not only to create hardships but may even have the effect of causing donors to give up making such awards.

The proposals covering deductions for medical expenses (paragraph 2.20) do not seem to be reasonable although the situation outlined in the White Paper, namely that methods of financing hospital care and medicare differ from province to province, is appreciated. Prior to the introduction of public hospital care and medicare individuals were entitled to reimbursement of expenses incurred over 3% of taxable income. The White Paper proposes to maintain the same 3% level but to eliminate a large part of the expenses formerly qualifying to meet the 3% limit. The individuals's situation will be substantially worse under the White Paper proposal. Medical expenses of substantial size are beyond the control of individuals and involve financial hardship; the 3% limit should be reduced to 2%.

The progressive reduction of the married exemption where a wife has income of over $100 is discriminatory and inequitable. Her income added to her husband's is taxed at the highest marginal rate of the combined incomes, leaving husband and wife less well off financially than an unmarried couple with exactly the same incomes living together. No mention is made of what will happen where part or all of the wife's income is in the form of dividends from widely-held Canadian companies. Will this part of her income be grossed up by 50%? If yes, does the husband then have the right to claim the corresponding tax credit? The effect of this White Paper proposal will be to impose a tax penalty on married women with modest incomes.

The Government should give consideration to introducing into the income tax act measures that will preserve the effective values of exemptions, deductions and tax brackets. Unless some such automatic compensating feature is built in further tax increases will occur as a result of inflation. If personal income taxes in Canada are to remain on a self-assessing basis it is imperative taxpayers be assured of the integrity of tax provisions, otherwise the high level of taxation will be self-defeating.

C. Employee benefits and pensions

Next to the substantial increase in total personal taxes Alcan is most concerned by the White Paper proposals covering taxation of pensions, lump sum payments and the like.

1) Pension plans and integration benefits

The proposal at paragraph 2.47 will deny trusts for retirement and retirement savings plans the right to claim the grossing up of dividends on shares of widely-held Canadian corporations and the tax credit which is to be allowed to individual recipients of such dividends. There will thus be an element of double taxation of income when it is paid out in pensions. This is neither consistent with Government philosophy of taxing pensions and pension benefits in full, i.e. taxing capital as well as income on the grounds that such plans have enjoyed complete immunity from tax, nor is it equitable.

This is another area in which the integration system is only imperfectly applied. Solutions are not easy to introduce, but it is suggested the Government gives consideration to (a) allowing a cash payment to Canadian pension funds to reflect part or all of the integration tax credit, or (b) as a palliative allowing an exclusion of some part of the pension payment from taxable income based on actuarial estimate of the dividend income included in the pension.

2) Limitations on investments of pension funds

The proposed limitation on investment of pension funds (paragraph 2.52) will increase employer pension costs if it reduces pension fund earnings. Restricted to the Canadian market, trusts will be unable to take advantage of opportunities where investment yields are higher elsewhere. Restrictive measures of this kind are likely to be followed by other countries and affect employers, such as Alcan, by limiting their ability to invest elsewhere pension monies arising in such countries.

3) Limitations on maximum contributions to pension plans

Alcan is disappointed the Government has failed at this time to propose an increase in the maximum dollar amount of contributions to pension and pension savings plans deductible from taxable income. The amount of $1,500 was established many years ago when the purchasing power of that amount was far in excess of the same amount of dollars today and is inadequate.

4) Imposition of 25% withholding tax on pensions paid to persons living outside Canada

The proposal set out at paragraph 1.46 to impose a 25% withhold-

ing tax on pensions paid to persons living outside Canada, but with provision for lower or higher rates where the circumstances of the recipient warrant it, will have very disturbing effects.

a) Foreign employees of multi-national companies are unlikely to accept a transfer to Canada when pensions accruing in Canada will be subject to 25% or more withholding tax;

b) Employees of Canadian branches or subsidiaries abroad, who have never set foot in Canada, but who participate in Canadian pension plans and who have never enjoyed any Canadian tax deductions in respect of their pension contributions will be adversely affected. Alcan has many such employees.

c) Many individuals presently in receipt of pensions from Canada have moved abroad for health or other reasons. A withholding tax on their pensions could be disastrous for many of them since they have already committed themselves.

d) All persons living abroad receiving a pension from Canada will, unless they have a total taxable income of $18,000 or more, be paying a higher rate of tax to Canada at the 25% withholding rate than will be the case if they are actually living in Canada. To obtain the lower rate of Canadian tax they will be obliged to file Canadian income tax returns and it is unlikely that host countries will then allow them full tax credit against taxes payable locally.

   If it is felt a withholding tax on pensions has to be levied it should be no more than 15%, it should not apply to any part of pensions earned by the individual while outside of Canada, should not apply to those individuals already resident outside of Canada, and in no case should it result in any higher tax than the individual would have paid had he received the pension in Canada.

5) <u>Taxation of all withdrawals from pension plans at ordinary income rates</u>

At paragraph 2.52 the government proposes to tax all withdrawals from pension and pension savings plans as ordinary income. The proposal is confiscatory in nature and the limited safeguards proposed by the government to prevent an undue amount of such payments being taken in tax are inadequate.

The "Mercer Actuarial Bulletin" for November 1969 gives two typical examples of what can and will happen, as follows:

"For example, an employee who has been in a pension plan

for 20 years and who dies might have accumulated contributions of $11,000 returnable to his beneficiary. If his earnings are $10,000 and have been for the previous three years, the tax on this refund might be some $1,950, leaving his widow $9,050 net after taxes. The proposed tax would be at least $4,000 (even if he used the "averaging back" provision proposed) leaving his widow a net of $7,000. The White Paper comments that these taxes can be deferred by transferring the amount to a registered retirement savings plan in the name of the widow, an option which currently exists, but often the need at such a time is for money in hand rather than a deferred annuity.

The example is more dramatic when the position of a participant under a registered retirement savings plan is considered. Assume a self-employed person who has contributed the $2,500 maximum to a plan for 15 years and who then dies. If the accumulation if $50,000, the current tax would be $7,500, the proposed tax up to $25,000. In both cases, the tax paid can exceed the tax saved through the deductibility of contributions, thus introducing a TAX PENALTY for having participated in a registered pension or retirement savings plan."

These particular provisions will render it most difficult for multi-national companies such as Alcan to persuade employees to accept a transfer to Canada. On termination of employment with Alcan, years after the employee has returned to his homeland, where he (or his estate after his death) is entitled to a lump sum distribution from the pension fund, the amount paid will be subject to tax in Canada. If foreign employees are exposed to this kind of tax Alcan's ability to transfer personnel to Canada will be further impeded.

D. General income-averaging option

The White Paper proposals in paragraphs 2.53 to 2.59 for income-averaging are completely inadequate. The Carter Commission stated it would not have contemplated taxation of capital gains without providing an adequate and reasonable 'averaging' formula. Alcan was critical of the Carter proposals, namely, that the five-year averaging formula of the "farmer-fisherman' type was inadequate when only partial inclusion of capital gains in the income base was proposed. The White Paper averaging formula, taking into account that it applies to capital gains at 100%, or 50% for widely-held Canadian companies, all deemed realizations of capital gains, and all the situations now covered under section 36 of the Income Tax Act, might almost as well not be included in the government's proposals so picayune and inadequate is the relief it provides.

There is no mention made in the White Paper of how employee share option, share purchase, profit sharing, savings and other similar plans will be taxed in the future. Section 85A of the Income Tax Act gives some protection in the form of an average rate of tax to certain kinds of employee benefits, and is certainly far superior to the general income-averaging option proposed in the White Paper. It is suggested not only that Section 85A be maintained, but as it does not apply to many kinds of employee benefits that it also should be extended to a much broader range of benefits than is now the case and that a third alternative method of taxation be built into it, namely of allowing individuals to pay tax, where appropriate, on the basis of:

a) Taking the whole benefit as taxable income in the year of accrual;

b) Paying a special tax on the benefit at the three-year prior average rate, as at present; or

c) Paying tax on the benefit as if it were a capital gain.

E. Personal reliefs re home ownership

It is recommended firstly that some portion of municipal and school taxes be allowed as a deduction from Federal income tax. The White Paper states that the principal direct taxes paid by individuals are federal income tax, provincial income tax and municipal and school taxes. Provision has been made to allow a credit for most provincial income tax paid by taxpayers. It seems logical that both federal and provincial income taxes should in turn make some allowance for municipal and school taxes.

Costs of public transportation, much of police protection, low cost housing, etc. are not benefits to householders any more than to tenants; and tenants enjoy lower rents than they otherwise would have to pay, and an advantage over home-owners to the extent landlords have been able to take the tax cost of general welfare and protection costs as a deduction from federal and provincial income taxes. The growing financial needs of urban communities require a redistribution of taxation, and allowing a deduction of municipal and school taxes from taxable income by the Federal and Provincial governments will provide some of the additional taxing authority needed by municipal organizations.

It is also recommended that some portion of mortgage interest on a principal dwelling be allowed as a deduction. Tenants benefit from the deduction landlords can make for interest charges; at present high rates of interest rents can be lower than they otherwise would be to the extent federal and provincial governments receive reduced taxes through deduction of interest from rents.

It is inequitable for home-owners not to be given the same right. The United States and the United Kingdom recognize this by permitting deduction of mortgage interest.

F. Taxing capital gains on a deemed realization basis

The difficulties of taxing deemed realizations are so many and the potential economic consequences so far reaching that it should not be contemplated. The high rate of estate tax makes it unnecessary and highly undesirable to subject unrealized gains at death to income tax.

The proposed taxation of capital gains on a deemed realization basis will seriously impede the transfer of managerial personnel between Canada and other countries as mentioned above in section II C on page 30.

ALCAN ALUMINIUM LIMITED

TABLE 3

Present Canadian personal income tax

1970 rates and allowances
(all figures in dollars)

	Gross income	Basic deduction	Contribution to pension plan 5%	Contribution to Can. pension plan	Taxable income	Total Federal tax including surtaxes, 4% old age tax, Canadian pension plan contributions and before provincial tax rebate
Unmarried individual	5,000	1,100	250	78	3,572	811
	7,000	1,100	350	85	5,465	1,347
	10,000	1,100	500	85	8,315	2,133
	12,000	1,100	600	85	10,214	2,731
	15,000	1,100	750	85	13,065	3,814
	20,000	1,100	1,000	85	17,815	5,916
	25,000	1,100	1,250	85	22,565	8,117
	30,000	1,100	1,500	85	27,315	10,438
Married, spouse, 3 children between ages of 16 and 21	5,000	3,750	250	78	922	215
	7,000	3,750	350	85	2,815	628
	10,000	3,750	500	85	5,665	1,404
	12,000	3,750	600	85	7,565	1,919
	15,000	3,750	750	85	10,415	2,803
	20,000	3,750	1,000	85	15,162	4,686
	25,000	3,750	1,250	85	19,915	6,889
	30,000	3,750	1,500	85	24,665	9,091

Notes:

Single exemption $1,000; husband and dependent spouse exemption $2,000; per child exemption (age 16 to 21) - $550; $100 blanket deduction re charitable donations in all cases.

TABLE 4

ALCAN ALUMINIUM LIMITED

Proposed Canadian personal income tax

Rates and allowances after 5-year phase-in of White Paper proposals

(all figures in dollars)

	Gross income	Basic deduction	Employment expense deduction	Unemployment insurance deduction	Contribution to pension plan 5%	Contribution to Canada pension plan	Taxable income	Federal and provincial tax and Canada pension plan contributions
Unmarried individual	5,000	1,500	150	73	250	78	2,949	807
	7,000	1,500	150	73	350	85	4,842	1,368
	10,000	1,500	150		500	85	7,765	2,306
	12,000	1,500	150		600	85	9,665	3,037
	15,000	1,500	150		750	85	12,515	4,123
	20,000	1,500	150		1,000	85	17,265	6,159
	25,000	1,500	150		1,250	85	22,015	8,345
	30,000	1,500	150		1,500	85	26,765	10,679
Married - spouse - 3 children between ages of 16 and 21	5,000	4,550	150	73	250	78	-	78
	7,000	4,550	150	73	350	85	1,792	505
	10,000	4,550	150		500	85	4,715	1,329
	12,000	4,550	150		600	85	6,615	1,953
	15,000	4,550	150		750	85	9,465	2,965
	20,000	4,550	150		1,000	85	14,215	4,822
	25,000	4,550	150		1,250	85	18,965	6,942
	30,000	4,550	150		1,500	85	23,715	9,131

Notes:

1. Single exemption $1,400; husband with spouse as a dependent $2,800; each child aged 16 to 21 - $550; $100 blanket deduction re charitable deductions in all cases.

2. Using tax rates in White Paper Table 2.

TABLE 5

ALCAN ALUMINIUM LIMITED

U.S.A. personal income tax

1970 and 1973 rates and allowances
(all figures in US dollars)

	Gross income	*Standard deduction	Itemized ** deduction	Exemption	Taxable income	Social security and unemployment tax 4.8% including .6% for medicare	Federal tax	Surtax at 2.5%	Total Federal tax
Unmarried individual, 1970	5,000	500		625	3,875	240	666	17	923
	7,000	700		625	5,675	336	1,042	26	1,404
	10,000	1,000		625	8,375	374	1,684	42	2,100
	12,000	1,000		625	10,375	374	2,191	55	2,620
	15,000	1,000		625	13,375	374	3,029	75	3,478
	20,000	1,000		625	18,375	374	4,645	116	5,135
	25,000	1,000		625	23,375	374	6,140	154	6,668
	30,000	1,000		625	28,375	374	8,659	216	9,249
Unmarried individual, 1973	5,000	750		750	3,500	240	595		835
	7,000	1,050		750	5,200	336	942		1,278
	10,000	1,500		750	7,750	374	1,530		1,904
	12,000	1,800		750	9,450	374	1,953		2,327
	15,000	2,000		750	12,250	374	2,703		3,077
	20,000	2,000		750	17,250	374	4,255		4,629
	25,000	2,000		750	22,250	374	6,090		6,464
	30,000	2,000		750	27,250	374	8,153		8,527
Married, spouse, 3 children, 1970	5,000		925	3,125	950	240	133	3	376
	7,000		1,295	3,125	2,580	336	383	10	729
	10,000		1,850	3,125	5,025	374	815	20	1,209
	12,000		2,220	3,125	6,655	374	1,124	28	1,526
	15,000		2,775	3,125	9,100	374	1,622	41	2,037
	20,000		3,700	3,125	13,175	374	2,554	64	2,992
	25,000		4,625	3,125	17,250	374	3,610	90	4,074
	30,000		5,550	3,125	21,325	374	4,804	120	5,298
Married, spouse, 3 children, 1973	5,000		925	3,750	325	240	46		286
	7,000		1,295	3,750	1,955	336	283		619
	10,000		1,850	3,750	4,400	374	696		1,070
	12,000		2,220	3,750	6,030	374	1,006		1,380
	15,000		2,775	3,750	8,475	374	1,485		1,859
	20,000		3,700	3,750	12,550	374	2,398		2,772
	25,000		4,625	3,750	16,625	374	3,435		3,809
	30,000		5,550	3,750	20,700	374	4,604		4,978

Notes:

* Standard deduction is in lieu of itemized deductions at option of the taxpayer. Standard deduction in 1970 is 10% of gross income or $1,000, whichever is the lesser. It is increased for 1973 as noted.

** Consists solely of property tax (4% x house valued at 2-1/2 times salary) and mortgage interest (8-1/2% x loan calculated at 40% of house value) Excludes state and local income, sales taxes and other interest on loans which are also deductible in the U.S.A. These figures are similar to the total national average. However, the figures above are probably underestimated as the total national average includes individuals not owning their own home.

IV. The taxation of international income

A. The exemption of foreign dividends by tax treaty

The proposal to exempt dividends from tax by treaty is not original. Several European countries proceed in this way. A major problem with the proposal is that this is new for Canada and that people have got into situations in reliance upon present law which will be intolerable if the rules are changed retroactively.

Another aspect is that there will be situations for Canadians where a tax treaty cannot be obtained, and yet dividend exemption is the correct solution to protect the foreign government's tax incentive investment policy.

Unilateral exemption (i.e. Section 28(1)(d) of the Income Tax Act) should not be withdrawn without substituting equivalent tax protection for existing investments and providing for unilateral exemption on a selective basis in the future.

Alcan prefers to see Section 28(1)(d) retained. However, if that is not possible, then it is recommended that:

1) exemption be extended to dividends from controlled foreign corporations resident in such non-treaty countries as are designated for this purpose by order-in-council; or

2) exemption be extended to dividends from such controlled foreign corporations resident in non-treaty, non-designated countries in respect of which the Minister of Revenue has issued a determination to the effect that the controlled foreign corporation is not used to artificially avoid Canadian tax; or

3) in the case of a controlled foreign corporation which proposes an investment in a less-developed country which is not covered by (a) or (b) above, the Minister of Revenue be authorized to issue to the Canadian parent corporation a ruling recognizing as creditable for Canadian tax purposes that amount of foreign tax spared or to be spared under a tax incentive arrangement provided by the foreign country involved.

Foreign tax credits

The White Paper proposes at paragraph 6.17 that dividends from controlled foreign corporations not entitled to exemption be taxed on the gross-up and credit basis including as credits underlying corporate income tax. The rules laid down to define applicable tax credit are vital and complex. It is urged that when a draft bill is submitted the public be invited for comment on such points at that time.

Two key problems of relevance to Alcan in this area involve the tiers of a subsidiary's earnings to be taken into account in arriving at applicable corporate tax paid, and the definition of relevant profits. As an example of the first matter, Alcan has many subsidiaries in Brazil. Due to Brazilian requirements there are subsidiaries with significant incomes and paying taxes which are in the fourth tier beneath Alcan, i.e. two or three corporate owners are interposed between the parent and the subsidiary. If Brazilian dividends from such a source are to be taxed in Canada, Alcan should be allowed to take all the Brazilian income tax into account in computing the relevant Canadian tax thereon. Alcan has similar third and fourth tier situations in other countries. The second matter concerns the rules to be applied in measuring incomes and taxes for use in the equations required to determine the creditable tax to be allowed.

The further proposals at paragraphs 6.25 and 6.26 of the White Paper to allow carry-overs of excess tax credits from one year to another and to recognize on a mutual basis income taxes paid to political subsivisions are excellent. Comment should be invited however when statutory language is available with respect to whether implementation is adequate to do the job required in each case.

B. Taxation of passive income of controlled foreign corporations

1) Application to widely-held corporations

At paragraph 6.20, the White Paper points out that tax abuses arise where a foreign corporation is used as a "device of convenience" to which interest, dividends, royalties and transshipment profits from "other sources" may easily be diverted. To counter this type of tax haven abuse, it is proposed to adopt law patterned generally on U.S. provisions.

Alcan recommends that if any such proposals for the taxation of passive income be adopted they be not applied to widely-held corporations.

The Government's intentions have not been explained or amplified in any way. It is not known whether the tax abuse involved is avoidance of Canadian tax (i.e. diverting Canadian source income to such a corporation) or whether it includes minimizing foreign tax as well. It is not known what is meant by "transshipment profits".

However, the U.S. law is available. If its concepts are followed, then the passive income proposals will affect every bona fide controlled foreign corporation which earns the least amount of the aforementioned kinds of income.

Alcan has foreign affiliates which are large bona fide enterprises in themselves with local shareholders owning anywhere from 5% to 78% of the voting stock.

These companies will in the normal course of business generate interest, dividends, royalties and international trading profits on their own independently of Alcan's control. Alcan has always favoured highly autonomous management in such subsidiaries, and rising nationalist feeling will reinforce this autonomy by requiring local participation in ownership as well as management in the future. Canadian tax rules should be designed not to harass such developments by imposing tax on Alcan arbitrarily in respect of non-operating income coincidentally earned by such bona fide foreign subsidiaries.

Alcan's European group of companies are becoming an increasingly potent force in the EEC aluminum industry. It is important to note that Alcan's growth in this area has led to considerable trading between these companies, for example extrusions or rolled sheet products from Germany are sold to the French or Italian sister companies for further processing, local sale or incorporation in another product. The U.S. tax rules have created major tax compliance and cost problems for American multi-national companies with similar developments since such inter-group trading is deemed by statute to be tax-abuse oriented. Alcan feels very strongly that Canada should not adopt legislation which has such consequences since it can be observed that such rigidity hurts the export potential of a country and the competitiveness of its enterprises operating on an international scale.

When the U.S.A. adopted its passive income rules it was in a very different situation from Canada today. Its tax law (and thus the quantum and type of so-called tax avoidance) was different, it had a different balance of payments problem and the attitudes toward foreign investment at that time were different. The U.S. legislation had a high degree of nationalist and protectionist support (attitudes which Canada can ill-afford with its much greater reliance on export). It is suspected that the U.S.A. today regrets having fastened these tax rules on its industrial enterprises because such rules are a handicap to export, produce no tax revenues due to the many reliefs provided, and are expensive to administer for government and industry alike.

If Canada adopts any proposals for taxing passive income Alcan recommends that Canadian widely-held corporations be excepted from the passive income revenue-protecting devices because existing tax rules already cover most tax minimizing avenues, because widely-held corporations cannot effectively divert income for the direct personal enrichment of shareholders and

because individuals or closely-held companies in fact will not go public simply to enjoy freedom from such tax rules.

If passive income rules are applied to widely-held corporations, then in order to maintain a reasonably competitive posture vis-a-vis U.S. multi-national and international companies, special relief rules at least equivalent to what the U.S.A. has adopted, such as those set out under sections (2) to (9) immediately below, will be required.

2) Minimum distribution exclusion

Under U.S. law a parent U.S. corporation may exclude from its taxable income for the year any and all passive income of its foreign subsidiaries if it has received from its foreign subsidiaries dividends which in the aggregate equal a required minimum percentage of the total earnings and profits of these corporations realized in respect of the year. The minimum distribution percentage is established in a table. It varies inversely with the effective foreign tax rate of the foreign subsidiaries as a group, i.e. if the average tax rate is 43% no minimum dividend is required whereas if the average tax rate of the foreign companies is 9% or less, 83% of the year's earnings must be received as a dividend.

If a similar provision is adopted by Canada this will permit Alcan to avoid major hardship with passive income rules since Alcan's foreign enterprises pay on the average a high rate of tax and their dividend distributions to Canada are at a high average level. Apparently, similar results are experienced by large U.S. corporations with many foreign subsidiaries. Alcan should not have imposed on it more severe rules in such matters than those imposed on its international competitors.

3) A "de minimis" rule

To avoid nuisance tax compliance problems, the U.S. Internal Revenue Code provides that where passive income of a controlled foreign corporation is less than 30% of its gross income, then none of such passive income is taxable. On the other hand, if the passive income of such a company income exceeds 70% of its gross income, then the entire gross income (subject to specific exceptions) is treated as passive income.

Alcan's foreign subsidiaries receive interest, dividends, or royalties in various amounts from year to year, but their receipts are generally insignificant in each case. A "de minimis" rule such as that found in the U.S. Code will be essential in the case of bona fide controlled foreign corporations to provide a workable law to exclude items of income which, in fact, are not tax avoiding revenues (for example, often such

interest is realized on mandatory deposits with government agencies, tax refunds, etc.) and to eliminate insignificant dollar amounts for reasons of administrative convenience. A similar exclusion in the order of 30% of gross revenue of the controlled subsidiary is recommended.

4) Definition of control

The U.S. Code defines a controlled foreign corporation for purposes of sub-part F to be any foreign corporation more than 50% of the total combined voting power of which is owned by five or fewer U.S. persons. A similar rule will be required for Canada to ensure that passive income rules are applied only to those foreign corporations in which the Canadian owners have sufficient equity to truly dictate decisions and reap the benefits.

5) Trading and service income

The U.S. law treats as passive income profits earned by foreign controlled companies in international trade where an affiliate is involved at either end of the trade, the final sale is to a country other than the place of incorporation of the controlled foreign corporation, and the goods or services are not handled or fabricated in some way in the place where the trading company is incorporated. However, a particular relief is provided whereby if such trading profits are continually reinvested in export trade assets, U.S. taxation is deferred.

Alcan's affiliated foreign trading companies purchase and resell over 50% of Canadian export tonnage and earn gross profits in the form of commissions or discounts based on arm's length criteria. Many sales are made by these trading companies outside their place of incorporation. The companies have large sales staffs, undertake major credit, foreign exchange and inventory risks, and pay significant local income taxes. In section (1) above, reference has also been made to a growing trend toward intercompany sales of fabricated aluminum products across national boundaries.

Existing tax rules are adequate to protect government revenue against artificial price arrangements to inflate the income of these companies. Canada's export trade will be under a major disadvantage if Canada treats the incomes of such companies as subject to Canadian tax. The brief of the Canadian Export Association discusses this problem more fully. If passive income rules are adopted and they are applied to widely-held companies, then they should apply only to personal company type income and not to sales and service income.

6) Shipping

The U.S. Code provides a specific exception in that passive income does not include income from shipping.

A similar exception is strongly recommended for Canada in order to ensure an adequate supply of bulk transportation for Alcan's bauxite and alumina requirements at competitive costs. All major foreign aluminum and steel manufacturers use shipping operations based in tax-havens to a greater or lesser degree for special reasons peculiar to the shipping industry, and tax legislation in advanced countries has been designed to accommodate their development to facilitate vertical integration on the cheapest terms possible.

7) Insurance

Under the U.S. Code, a controlled foreign corporation can receive premiums on insurance or reinsurance of U.S. risks without U.S. tax involvement up to 5% of the total premium revenue earned on all its insurance business. Taxable income attributable to premiums on U.S. risks in excess of the 5% level is taxed to the U.S. parent in the year received.

In view of the much weaker insurance industry in Canada (as compared with the U.S.A.) and the increasing unavailability of major risk coverage in world insurance markets large multi-national corporations are obliged to consider self-insurance arrangements which involve tax problems of this kind.

Alcan recommends the total exclusion of insurance operations from any passive income rules adopted at this time.

8) Exceptional transactions

The U.S. law provides that passive income does not include any item of income received by a controlled foreign corporation if it is established to the satisfaction of the Treasury that neither the creation of the controlled foreign corporation nor the effecting of the transaction through it has as one of its significant purposes a substantial reduction of income tax. Such a provision is important to avoid unintended tax problems where, due to extraordinary events, a major item of passive income is received in a year which takes it out of the "de minimis" class.

A similar rule will be required for Canada, particularly if passive income is defined to include capital gain. Foreign corporations in which Alcan has a controlling interest frequently reorganize, merge, sell interest, etc. and these

changes can give rise to capital gains in cases where Canadian tax avoidance is not the motive for such deals.

9) Subsequent adjustments, accounting rules, currency blockage, etc.

When the U.S.A. determined to tax passive income as earned by controlled foreign corporations a policy problem arose as to how to recognize tax adjustments when such income was repatriated to the U.S.A. at a later date as a dividend in the normal way. Passive income included in a dividend cannot be taxed a second time so an exclusion was required, and a withholding tax has now to be allowed as a credit in respect of the previously taxed item. This requires complicated law, regulations and accounting. Similar rules will be required by Canada to permit passive income to be eventually repatriated tax-free.

Another difficult problem experienced by the U.S.A. concerned measuring the foreign income subject to tax. It was decided that U.S. dollar values and accounting principles would be applied, and that large credits or debits to the income or surplus accounts arising due to fluctuations in the value of currency would be treated as passive income for tax purposes. Difficult accounting and tax policy problems still arise as to the true economic meaning of such accounting entries. Canada will involve itself in similar problems. Alcan's experience in exchange-sensitive countries such as Brazil or India suggests this problem should be avoided because compliance will be difficult and very expensive.

Finally, a tax policy will be required to permit a taxpayer to identify but defer tax on items of passive income where remittance in hard currency from the foreign country is forbidden due to exchange control.

C. Defining the controlled foreign corporation

It is proposed at paragraph 6.15 of the White Paper that a foreign corporation will qualify as a controlled foreign corporation if at least 25% of its voting shares are owned by a Canadian corporation. If the corporation is a controlled foreign corporation and it is located in a country that has a tax treaty with Canada, then any dividends paid by the foreign corporation are tax-free to the Canadian company. If the stock investment is less than 25% the holding is treated as a portfolio investment taxed at 50% in Canada with credit for dividend withholding tax but no credit for underlying corporation tax.

However, if the stock investment is 25% or more but there is no tax treaty, dividends are taxable at 50% with credit allowed for underlying foreign corporation tax. Thus, so long as a 25% share-

holding is obtained the Canadian corporation will have a materially better return on its investment than if it accepts a lesser participation, as shown in the following figures:

	25% and treaty	25% and no treaty	Less than 25%
Dividend (before 15% withholding tax)	$100	$100	$100
Underlying corporation tax (40%)		80	
Taxable amount		180	100
Canadian tax	-0-	90	50
Tax credit - underlying corp. tax		(80)	-0-
- withholding tax	(15)	(15)	(15)
Net Canadian tax	-0-	-0-	35
Net dividend	$ 85	$ 85	$ 50

The cut-off point between controlled foreign corporation and portfolio status is set much too high when one considers the extensive differences in tax treatments which follow. Under present law, the distinction is not troublesome in fact, because wholly-owned foreign holding companies can be used to hold less than 25% participations thus conforming to Canadian law for exemption from Canadian tax. The passive income rules presumably will put an end to this solution.

Clearly, a portfolio holding which ought to be taxed with allowance only for withholding tax should be one which is held for return and is readily marketable, i.e. it is not so large as to be not readily disposable. The U.S. and U.K. rules are that less than 10% interests are taxed on the portfolio basis. It is also relevant that many stock exchanges and securities control agencies require disclosure of acquisition of more than 10% in a company. This suggests that 10% is a real cut-off between true portfolio and true strategic interest.

Alcan favours either tax exemption for dividends on holdings between 10% and 25% in voting interest or taxing them on the same basis as proposed for non-treaty controlled foreign corporations i.e. the gross-up and tax credit basis recognizing underlying corporate tax.

This is important to Alcan because it has one major investment where it is limited by local law to a 22% equity participation. The investment is strategic and there is in fact no market for the shares, the balance being owned by a large local industrial combine. Since local corporate tax plus withholding tax equals or exceeds Canadian taxes, it does not appear right for Canada to collect additional tax on the dividends in this instance.

It also seems quite likely that other Canadian companies interested in export opportunities will find it desirable to participate in

foreign ventures where they cannot get or cannot afford a 25% interest. The rule suggested above will benefit them as well.

D. Withholding tax on non-residents

It is proposed at paragraph 6.38 of the White Paper to increase Canadian withholding tax from January 1, 1971 to 25% on a wide range of remittances including interest, royalties, etc. Of course, where existing tax treaties apply a different rate this will be respected.

Where Canadian companies have existing obligations to non-treaty countries they will frequently suffer the added cost since the practice is increasingly to oblige the debtor to absorb withholding tax. Existing obligations should be excluded from the increase as was done in 1960.

As to future policy, Alcan recommends that the government considers adopting the OECD patterns of withholding rates to be implemented by the treaty (10% on interest, 5% on dividends paid by controlled companies). In the present era of high interest rates, a 15% gross withholding frequently exceeds 50% of the lender's net profit. The lender cannot recoup all the tax and therefore obliges the Canadian borrower either to pay a higher rate or to absorb all the withholding. Alcan's recent experience indicates that issues placed in the United States subject to 15% withholding tax are not acceptable at all to certain investors because of the withholding tax and that a higher coupon rate is then required by the underwriters to ensure a successful placement with other investors. Generally, European lenders are unwilling to pay any withholding at all so that the cost of withholding tax on Euro-dollar issues is absorbed by the Canadian borrower.

Government has exempted Canadian public debt issues from the withholding tax obligation. Some similar relief is increasingly important for Canadian industrial borrowers who will be obliged to borrow abroad in a world becoming more capital-short every year. For example, the U.S.A. provides in its code an arrangement whereby U.S. companies can use a subsidiary to borrow abroad free of U.S. withholding tax. Some similar arrangement is needed in Canada for multi-national corporations based here.

E. Flow-through of foreign withholding taxes

At paragraph 6.27 it is proposed to permit a Canadian company to recoup withholding tax it has suffered on foreign dividends received by means of a withholding tax on dividends paid to resident and non-resident shareholders alike. This is a logical and essential adjunct to the integration scheme if the latter proves to be desirable and workable, but implementation will require special care. Alcan urges consideration of the following

suggestions:

1) Foreign income be treated as first-in-first-out so that computations of flow-through credits can be kept current.

2) The Canadian parent company be deemed to be the recipient of all foreign dividends so that control accounts need not be required in closely-held subsidiaries.

3) At least a one-year carry-over of withholding tax in excess of the permissible 15/85's limitation should be permitted to avoid difficulties in respect of unusual fluctuations in foreign dividends from one year to another. This carry-over will be in the same vein as the carry-over of withholding and income taxes for purposes of foreign tax credit indicated at paragraph 6.25.

4) If for any reason a dividend is remitted to a non-resident subject to a rate of Canadian withholding tax which is less than the maximum permissible flow-through recoupment (i.e. 15/85's), the difference be recovered by refunding the appropriate amount to the distributing corporation on application by it to the National Revenue Department. This is consistent with treatment applicable where a foreign tax-exempt shareholder is entitled to apply for refund of such withholding tax. Such problems may arise for example where the withholding rate is reduced below 10% by tax treaty or is zero where a foreign government owns shares in the Canadian parent company. Such a rule seems necessary to achieve the purpose of the flow-through as expressed at paragraph 6.29 as between resident and non-resident shareholders particularly where non-resident withholding rates are less than 15%.

V. Other matters. Business and property income

Certain other matters of concern to Alcan in the White Paper and the existing tax system, which are not discussed in the main brief, are set out below.

A. Depreciation

1) It is a genuine disappointment to note that the government is considering reducing the return on industrial investment, especially capital intensive investments, by reducing present levels of capital cost allowances.

2) The proposal to terminate the deduction from other income of losses on rental buildings attributable to capital cost allowance, interest and property taxes in excess of rental revenue is bad policy since it will discourage construction by large and small operators alike.

Alcan has subsidiaries engaged in the house and apartment construction field, and is also a large supplier of construction materials to the building trade. This proposal is certain to have a negative impact on this business.

It is recommended that the proposed changes be not implemented. If some restriction on deductions from non-business income is required, a more acceptable rule will be to limit deductions from other income on account of a property investment to an amount not in excess of $25,000. Such a proposal is similar in kind to the allowance for loss from farming provided by Section 13 of the Income Tax Act. A larger dollar amount of permissible loss deduction is suggested in view of the social need for rental housing and the lesser likelihood for personal use of the property.

B. "Nothings"

The proposal at paragraph 5.4 to introduce deductible allowances in respect of so-called "nothings" is sound. ("Nothings" are business expenditures which are not deductible in computing taxable income in any form.) However, it may not go far enough to eliminate the various categories of non-deductible business expenditures which have developed under the present Income Tax Act. It is suggested that all business expenses heretofore treated as non-deductible should be allowed on some basis and that in appropriate cases a fair portion of expenses incurred prior to commencement of the new system should be allowed subsequently as well.

The denial of interest deductions to corporations under Section II (1)(c) where borrowed money is used to acquire shares, for example, should be withdrawn because it only injures those who have not been able to avoid its stricture and because in conjunction with integration it is wrong -- i.e. it results in effective tax

rates higher than 50% which the Canadian shareholder cannot recoup by means of integration.

Another important example concerns bond discounts and premiums. "Original issue discount" is the amount less than par which the first purchasers of the bonds pay. Sometimes this difference from par can be a premium. A redemption premium is a negotiated additional price paid for the right to redeem bonds prior to maturity. Such discounts or premiums are usually established in relation to the coupon rate so that the bonds yield to maturity a rate of interest which the market demands at the time. The conventional wisdom in Canada is that these sums are in the nature of capital payments and are not deductible to the issuer or taxable to the receiver (other than a dealer). There is also the discount or commission which is allowed to the underwriting syndicate selling corporate bonds as compensation for its services. Section 11(1)(cb) of the Income Tax Act provides that this amount may not be deducted by the bond issuer. The reason for this is difficult to understand since the syndicate is taxable on its receipts but it has been the law for a number of years.

Under tax reform these discounts, premiums and commissions ought to be deductible expenses to the issuer in respect of new issues because they represent a true cost of borrowing for the purpose of earning income. However, what treatment is to be applied to bonds issued and outstanding <u>before</u> the new law comes into effect?

Since it is proposed that in the future discounts and redemption premiums will be taxable in the hands of the Canadian recipient when realized, the government is effectively going to tax such amounts realized on existing issues. Therefore, the government ought to allow the issuers a tax deduction for discounts and redemption premiums allocable to the remaining life of outstanding bond issues. For consistency, corporations which issued at a premium bonds outstanding at the commencement of the new system in theory should be obliged to credit to income a ratable portion of such premiums. This will not work a particular hardship so long as allowance is made for a relevant portion of underwriting commissions in respect of such issues.

C. <u>Holding company provisions</u>

Section 12(6) of the present income tax act permits a holding or investment company as defined therein to deduct all of its business expenses notwithstanding that a material part of its income may be tax-exempt (i.e. dividends from taxable Canadian corporations or from controlled foreign corporations). This provision should be retained for the reasons set out under B immediately above, i.e. under integration there should be no categories of non-deductible expenditures at the corporate level.

D. Income tax payments

Over the last four years the Federal government has accelerated the installment payment of income tax so that where formerly tax was paid 180 days after the month in which a sale was booked, the point has now been reached where in 1970 tax is to be paid in the month in which a sale is made. Such an acceleration in payments is really a tax increase in disguise.

Table 6 at the end of this section shows the Aluminum Company of Canada's installment tax payments for the year 1969 as they would have been payable under the law as it was in 1967 and as it is now in 1970, and indicates a $15.0 million acceleration in cash payments as between these two bases.

Since export sales are customarily made on credit terms ranging from 60 to 180 days, tax will be paid long before the cash is realized, imposing increasingly important restraints on the cash resources of the company. Such unusually current payments of corporate income tax are not necessary to the efficient working of an integrated tax system and modification can be introduced to ease the competitive injury inherent in this arrangement.

Corporate income tax payments should be more or less self-financing out of receivables as are tax withholdings on wages and salaries. In principle, a three-month delay in payment of tax should be accepted as the minimum necessary to protect against an unreasonable encroachment on the working capital of business. The return to this principle should be a cardinal fiscal step once the immediate inflation crisis is past, in order to be competitive with similar obligations imposed in other major industrial countries.

This problem is a serious matter facing all of Canadian industry. As an example, at today's interest rates (say 9.5%) the prepayment of income tax will cost Alcan in interest about 50 cents per ton of aluminum sold for each month of credit extended the customer just to finance the income tax element in the receivable. Table 7 at the end of this section indicates corporate tax payment rules in the U.K., U.S.A., France, Germany and Japan, all of which are more favourable than those now applying in Canada. A payment schedule more or less like that in the U.S.A. is recommended for Canada.

ALCAN ALUMINIUM LIMITED

TABLE 6

Aluminum Company of Canada, Limited
1969 Federal income tax installment payments - January to December
on 1967 and 1970 bases

$ millions

	Month	Payments per Section 50 (1) as required 1967	Payments per Section 50 (1) as required 1970	Increase
1969	January	-	$ 2.8	$ 2.8
	February	-	2.8	2.8
	March	-	2.8	2.8
	April	-	2.8	2.8
	May	$ 2.3	2.8	.5
	June	2.3	2.8	.5
	July	2.3	2.6	.3
	August	2.3	2.8	.5
	September	2.3	2.8	.5
	October	2.3	2.8	.5
	November	2.3	2.8	.5
	December	2.3	2.8	.5
		$18.4	$33.4	$15.0

Note: This table reflects installment payments which would be required to be paid in 1969 in respect of taxable income earned in 1969 on the two bases. It does not reflect the additional final payment required in the subsequent year when the total amount due is known.

ALCAN ALUMINIUM LIMITED

TABLE 7

Comparison of provisions for installment payment of corporation income tax in various countries

(All data assume taxation year is the calendar year)

U.S.A.(1)	25% April 15, 25% June 15, 25% September 15, 25% December 15 of estimated tax for the year less an exclusion which for 1970 will be 40% of the total tax liability. By 1977 installment obligations will equal full estimated tax for the year.
Germany (2)	25% March 10, 25% June 10, 25% September 10, 25% December 10 on estimated tax liability generally equal to that paid in the immediate preceding year.
Japan (3)	50% August 31; balance due February 28 year following with return. Delays are allowed under prescribed circumstances.
United Kingdom (4)	The entire sum to be paid by the later of nine months after the end of the accounting period or one month after the making of the assessment.
France (5)	25% March 15, 25% June 15, 25% September 15, 25% December 15. Each payment equals one fifth of the total tax paid in respect of the preceding year. Within 3-1/2 months of fiscal year end final payment to pay off actual tax due.

(1) Section 6154, Internal Revenue Code.
(2) Paragraph 12/1.6 and 12/2.2, Germany, Harvard World Tax Series, Commerce Clearing House, 1969.
(3) Paragraphs 270, 271, Guide to Japanese Taxes 1965, Hayashi, Taizo, Zaikei Shoho Sha.
(4) Paragraph 6, Corporation Tax, 2nd ed., Carmichael, HFL (Publishers) Ltd.
(5) Information Guide for Doing Business in France, Price Waterhouse & Co., October, 1969.

APPENDIX "G"

BRIEF BY

INVESTMENT DEALERS' ASSOCIATION OF CANADA

GOVERNMENT WHITE PAPER "PROPOSALS FOR TAX REFORM"

TO
SENATE COMMITTEE
ON
BANKING TRADE AND COMMERCE

APRIL, 1970.

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INTRODUCTION

1.1 The Investment Dealers' Association of Canada has given careful consideration to the proposals for tax reform which the Minister of Finance presented to Parliament on November 7, 1969, and appreciates the opportunity to offer our views on these proposals to this Committee.

1.2 The Association commends the Government for publishing the proposals in a White Paper and welcomes the Minister's assurances that the Report and Recommendations of this Committee will be taken into consideration when legislation is being drafted for presentation to Parliament.

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1.3 The 140 investment houses which comprise the membership of our Association have some 750,000 clients located in every community of any size in Canada. These clients range from individuals of limited means, with only a few dollars to invest, up to the largest business and government organizations. Investment banking services provided to clients include: the underwriting and primary distribution of new issues of government and corporate securities; dealings in money market securities; maintaining secondary markets in outstanding securities; investment counsel; portfolio management and a variety of fiscal agency functions including assistance in arranging mergers and takeovers. Members also operate stock-brokerage businesses through memberships in Canadian and American stock exchanges and carry on an international trade in securities through offices and correspondents in the United States and abroad. Few other national organizations are in closer contact with such a wide and diversified range of individual, corporate and government interests throughout Canada and abroad.

1.4 Since the publication of the White Paper, the Association and its members have received scores of inquiries as to the implications of the Government's proposals and many expressions of concern. The viewpoints and concerns expressed in this Brief are therefore not solely those of the Association or its members; they are also the concerns expressed by a wide and diversified cross-section of the investing public. We believe they are legitimate, and deserving of objective consideration.

1.5 The national tax structure is one of the major instruments which is used by the Government to ensure the health and growth of the national economy. The wisdom or otherwise of the proposed tax reforms must be assessed both on their individual merits and on their combined short and long-range impact on the economic and social objectives which we set for ourselves as a nation.

1.6 The soundness of this approach is recognized in the introduction to the White Paper in the enumeration of the goals which the Government asserts to have used as guidelines in its preparation. These goals include: a fair distribution of the tax burden; steady economic growth; the recognition of modern social needs; readily understood and accepted tax laws; the blocking of loopholes which invite abuse and the development of a tax system that can be used by the provinces as well as the federal Government.

1.7 The White Paper gives priority to achieving neutrality in the income tax system, apparently in the belief that this would produce the most equitable tax system. The Association rejects the proposition that neutrality is synonomous with equity in the present economic context and suggests that greater emphasis be placed on the attainment of economic growth and

productivity. The better society we seek will not be attained through a redistribution of present wealth if such redistribution prejudices increased productivity - and hence, future wealth. One example will suffice to illustrate our point: Some 20% of all tax revenues are devoted to education and a vast increase has taken place in the last ten years in the number, size and types of educational institutions and in the number of young people in attendance. In the 1970's hundreds of thousands will graduate from our post-secondary institutions and seek to find a useful place in society. Only a growing economy will provide the number and the calibre of employment opportunities required. To fail to provide these will result in unemployment, underemployment of training and talent and widespread disillusionment with Canadian society and the Governments responsible for such conditions.

1.8 Thus we must seek the maximum development of the national economy to make possible progressively better living standards for all Canadians and the attainment of their desired social, as well as economic, goals.

1.9 In setting economic policy, the inescapable relationship between economic progress and the attainment of desired social goals should, of course, be recognized and respected. The day is past when those primarily concerned with development of physical and human resources can ignore the concern of an increasing number of citizens for the qualitative aspects of Canadian life. The shift in emphasis today is toward human values and human needs and this fact is being recognized by governments and by the Canadian business community.

1.10 However, those primarily concerned with social objectives must recognize that the physical wherewithal to accomplish social progress comes from the productivity of the

national economy. Interest in maximum economic growth must therefore be a mutual concern of all segments of the economy and of all levels of government. It is the buoyancy and productivity of the Canadian economy that will make possible the attainment of the desired social goals and it is of the utmost importance that the Canadian tax structure be designed and used as an effective instrument to encourage and facilitate this inter-related economic and social progress.

1.11 We believe that our concept of Canada's economic and social objectives is in harmony with the views expressed in the following authoritative sources:

1. The preamble to the Bank of Canada Act which reads, in part, as follows:

"WHEREAS it is desirable to establish a central bank in Canada to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion . . ."

2. The evidence given by the third Governor of the Bank, Louis Rasminsky, in his appearance before the Royal Commission on Banking and Finance in 1963 which was, in part, as follows:

". . . the broad objectives of monetary policy are those of public economic policy generally, . . . --- they may be said to include: sustained economic growth at high levels of employment and efficiency, internal price stability and the maintenance of a sound external financial position, an equitable sharing of economic benefits and burdens and the maintenance of a high degree of economic freedom."

3. The Report of the Royal Commission on Banking and Finance which contained many well-reasoned guidelines for the formulation of fiscal policy, some of which are contained in the following extracts:

"It must be clearly recognized that one of the principal functions of the Government of Canada is to order its tax and expenditure policies so as to contribute to high employment, stable prices, economic efficiency and a sound external position." (p. 507)

"Our general position is that the limited effects of monetary and debt policies alone require that more use be made of fiscal policy as part of a co-ordinated economic policy than has been the case in the past." (p. 520)

"Regardless of the circumstances in which fiscal policy may be needed, it is important that the government plan its measures deliberately. Haphazard measures are always disturbing, especially if they are unco-ordinated with other aspects of policy. Similarly, a series of minor measures or fiscal steps which have more eye-appeal than effects are no substitute for a broad and well-thought-out general policy which is clearly aimed at stabilizing the economy." (p. 521)

"First and most important, the authorities must get the broad "set" and timing of general policy right;
. . . Secondly, if a suitable policy climate is to be created effectively, monetary, debt, fiscal and international economic policies -- as well as other non-financial measures -- must be co-ordinated into a coherent whole." (p. 523)

"We have found that each individual strand of policy has effects sufficiently powerful that it cannot be a matter of indifference if it is wrongly set or ignored. . . .
. . . the results of a program or policy which is wrongly conceived can be serious." (p. 537)

1.12 To the knowledge of the Association these economic aims and objectives are not at issue in any of the world's industrially developed countries. Indeed, in some of them, there is legislation aimed at their implementation -- for example, the Employment Act of 1946 in the United States requires Congress to see that all practical means of promoting these objectives are used and a Joint Economic Committee of Congress was created to examine annually the performance of the economy.

1.13 Experience over the years throughout the world has indicated that conflicts in relation to these national objectives arise only on how policy should be implemented. This seems to be principally a problem of allocating priorities in such a way as to maximize the desired aims. It should be pointed out that on occasion, benefiting from hindsight, the priority list has not always been too well selected. To use adjectives from the extracts from the Porter Report quoted above, policy in Canada has not always been "well-thought-out", "deliberate" and "co-ordinated". Rather it may have been "wrongly conceived", "haphazard" and "unco-ordinated".

GENERAL CONCLUSIONS

2.1 In evaluating the tax reform proposals, the Association has considered the extent to which adoption of the proposals would contribute to the attainment of each of the stated goals or objectives set out in the White Paper.

2.2 A number of the proposed amendments are obviously desirable, either in their present form or subject to some minor modifications, as they would eliminate anomalies in the present Income Tax Act and would not in themselves have any harmful economic effects.

2.3 We have reached the opposite conclusion with respect to what we consider to be some of the more fundamental proposals in the White Paper such as those relating to:

1. capital gains and losses
2. integration of personal and corporate income taxes, and
3. the shift in the tax burden as implied by the changes in basic exemptions, the rate schedule changes and the inadequate relief afforded by the averaging provisions.

2.4 In addition, we believe that inadequate consideration has been given in drafting the proposals to,

1. the effect of the elimination of the lower corporate tax rate on the financing problems which confront small businesses during expansionary stages,
2. the impact of the changes in the taxation of mineral income on the development of Canada's mineral resources and on the problem of regional development,

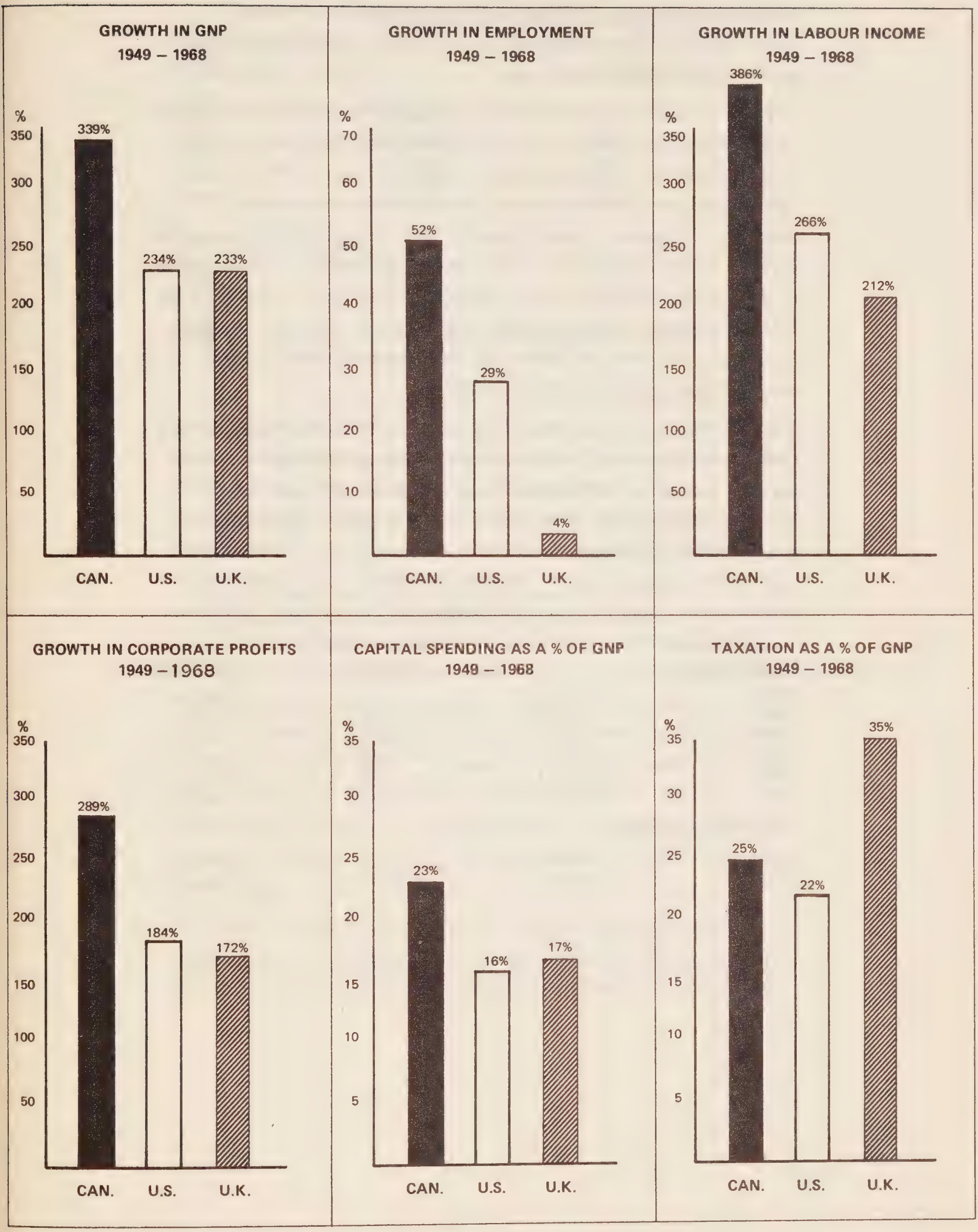
3. the inequities that could arise as a result of the proposed changes in the taxation of trusts, and
4. the unnecessary complexity that would result from the introduction of measures similar to those contained in Sub-part F of the U. S. Internal Revenue Code.

2.5 It is recognized that reform of some type is warranted in these areas. However, as discussed in the following sections of this Brief, we believe that there is considerable evidence to support the view that the specific changes proposed in the White Paper would have a harmful effect on economic growth, especially if the process of reform is exploited to produce one of the largest tax increases in Canada's history. We are also of the opinion that these proposals would not result in any significant over-all improvement in the present tax structure as a means of attaining the other goals or objectives set out in the White Paper and that this, when taken together with the probable harmful economic effects, must be accepted as a powerful argument against the adoption of these particular proposals.

2.6 It is our view that the present income tax system, in spite of its deficiencies, has served the country well during the past twenty years and we see no reason why it cannot continue to do so, subject to the changes recommended later in this Brief.

2.7 Since 1949, Canada has made immense economic progress as compared with the United States and Britain, as indicated by the Charts on the following page.

2.8 It is evident that the Canada Goose has been laying larger golden eggs more frequently than some of her friends. Therefore, we do not think her feeding habits or her environment should be changed too much. In other words, we are strongly


GROWTH IN GNP
1949 – 1968
%
350
300
250
200
150
100
50
339%
234%
233%
CAN.
U.S.
U.K.
GROWTH IN EMPLOYMENT
1949 – 1968
%
70
60
50
40
30
20
10
52%
29%
4%
CAN.
U.S.
U.K.
GROWTH IN LABOUR INCOME
1949 – 1968
%
350
300
250
200
150
100
50
386%
266%
212%
CAN.
U.S.
U.K.
GROWTH IN CORPORATE PROFITS
1949 – 1968
%
350
300
250
200
150
100
50
289%
184%
172%
CAN.
U.S.
U.K.
CAPITAL SPENDING AS A % OF GNP
1949 – 1968
%
35
30
25
20
15
10
5
23%
16%
17%
CAN.
U.S.
U.K.
TAXATION AS A % OF GNP
1949 – 1968
%
35
30
25
20
15
10
5
25%
22%
35%
CAN.
U.S.
U.K.

opposed to abrupt, "radical", far-reaching tax "reform" which could be detrimental to our present social and economic achievements and future aims.

2.9 While it is difficult to correlate international economic data, it is clear that we have experienced remarkable growth in GNP, employment and labour income. It is not merely a coincidence that this occurred during a period of fiscal stability. However, some signs of deterioration have appeared on the Canadian economic scene in recent years. For example, in the period 1965 to 1968 corporate profits declined from 12% to 10% of GNP, capital spending decreased from 25% to 22%, while taxes doubled in the seven year period 1962 to 1968, reaching over 30% of GNP in 1968.

2.10 One major contributing factor to the deterioration has undoubtedly been the excessive growth in government expenditures. As tabulated below, these expenditures have been growing much too fast, both absolutely and as a percentage of gross national product.

All Government Expenditures (ex Transfers)
$ Millions

Years Ending March 31st		Year to Year Increase	% of GNP
1965	$14,480		29.1
1966	16,367	+ 13%	29.8
1967	18,687	+ 14%	30.4
1968	21,330	+ 14%	32.5
1969	23,151	+ 9%	32.4
1970	26,094	+ 13%	33.4
Ten Year Increase			
1961	10,811		28.6
1970	26,094	+ 141%	33.4

Federal Government Expenditures

Years Ending March 31st		Year to Year Increase
1965	$7,876	
1966	8,491	+ 7%
1967	9,685	+ 14%
1968	11,020	+ 14%
1969	11,980	+ 9%
1970	13,208	+ 10%
Ten Year Increase		
1961	6,435	
1970	13,208	+ 105%

Source: Table 1 of Tax Structure Committee Report dated February 16-17, 1970.

2.11 The projected rate of increase in government expenditure for 1971 continues to exceed the expected rate of increase in GNP, despite "austerity". It seems obvious that Ottawa has been unable, despite good intentions, to regain control of the purse strings. When viewed in the context of "tax reform" which seeks to increase government revenues to do "useful and important things", it is not surprising that we, and many other Canadians, are concerned. For example, in his recent Budget Statement, the Honourable Charles MacNaughton, Treasurer of Ontario, stated that the "proposals have been designed to produce a significant increase in federal revenue-raising capacity, a move which we regard as totally retrograde". Whatever the "useful and important things" may be, we can see no justification for asking Canadians to submit to additional taxation to pay for unknown programs until it is clearly established that we are able to afford them.

2.12 Moreover, we believe strongly that most Canadians want a chance to experience rising standards of living with greater discretion over the spending of their own earnings

and are not "demanding" more government services. The shocking increases in government spending must be stopped and to this end we recommend that a Royal Commission be appointed to examine and confirm the necessity of limiting government spending to a level not to exceed a fixed percentage of GNP.

WHITE PAPER OBJECTIVES

1. ECONOMIC EFFECTS

3.1 In Paragraph 1.6 of the White Paper, one of the stated objectives of the tax reform proposals is to promote "steady economic growth and continuing prosperity". However, the Government qualified this statement in a subsequent paragraph by saying that another related objective is "to see that the tax system does not interfere seriously with economic growth and productivity".

3.2 It is also stated that the proposals are expected "to have relatively modest impacts on the Canadian economy" and that there would only be "some moderate reduction in aggregate private saving and probably some reduction in -- capital expenditures" which would "be offset by a small immediate increase in public revenues, and a rather larger increase after the early transitional years". We are not happy with the implication that the Government, which has frequently proven itself to be inept and extravagant in its spending, presumes to be able to make better use of funds than the private sector. We also wonder at the Government's rationale in interfering, seriously or otherwise, with economic growth or productivity or to cause any reduction in saving and capital expenditure. Surely equity and neutrality in the tax system are not worth the risk of slower economic growth over the longer term.

3.3 The White Paper contains some analysis of the expected economic consequences that would follow from implementation of the proposals but the discussion in many areas is vague and inconclusive and deals only with generalities. There is none of the rigorous economic analysis that is necessary to arrive at a sound decision as to the probable

effects of the proposals; nor is there any indication that the Government has in fact prepared any detailed studies containing quantitive measurements of the over-all impact of the proposals on the economy -- other than estimates of the possible effect of the proposals on tax revenues and on savings by the private sector. Indeed, some of the comments by the Minister of Finance and by members of his Department before this Committee have betrayed some uncertainty on their part as to the effect of the proposals and have led to the conclusion that detailed studies have not in fact been prepared.

3.4 The general conclusion reached by the Government was that the proposals "are expected to have relatively modest impacts upon the Canadian economy" and that there would only be a "moderate reduction in aggregate private saving and probably some reduction in . . . . capital expenditures" which "would be offset by a small immediate increase in public revenues, and a rather larger increase after the early transitional years". In support of this conclusion, some comment is made as to the effect on incentive to work and save, on migration, on the quantity and allocation of savings, on business investment and on Canada's balance of payments position. As discussed in Appendix "A" attached, the Association disagrees with many of these comments and suggests that the Government has understated the probable harmful effects. We also believe that the commentary is far from complete in that it fails to deal with many issues that should have been taken into account in determining the impact on economic growth.

Interest Rates and the Bond Market

3.5 For example, it is our view that inadequate consideration has been given to the effect of the proposals on interest rates and the bond market. As this Committee is well aware, the

historically high interest rates which have prevailed in the past eighteen months or so have been world-wide. This condition stemmed largely from changes in supply and demand relationships, with the supply of savings from conventional sources throughout the world not increasing as rapidly as the demand for funds required to finance extensive capital expansion.

3.6 In Canada, in particular, government undertook to expand the services it felt its citizens required at a time of rapid growth in the private sector. The combined demands of the private and public sectors upon the supply of savings caused interest rates to rise to attract additional sources of capital and led to inflation, which never before in Canada's history has been so widely recognized and anticipated by the public.

3.7 As expectations of inflation became more prevalent, those who did elect to save and invest sought to offset inflationary impacts on their investments. As a result, interest rates continued to rise and since the domestic pools of capital were inadequate, there was a continuing dependence on non-resident capital. During 1969, these stresses in the capital market gave rise to changed patterns of financing, leading to optional maturities on government borrowing and, in the case of corporate borrowers, equity features as well as term options. The table and commentary in Appendix "B" enlarges on these recent patterns.

3.8 Those seeking funds during the last two years experienced extreme difficulty in obtaining their capital requirements, excepting perhaps the federal Government. Ottawa was able to obtain its funds largely as a result of the expansionary policy of the Bank of Canada, resulting in undesirably large increases in the holdings of federal debt

securities by the banking system. In addition, the federal Government was able to embark upon massive Canada Savings Bonds programs. Some indication of the extent and effect of these financing programs is indicated in the table below:

Distribution of Government of Canada Debt
$ Millions

	March 31, 1967	March 31, 1969	Increase
Bank of Canada	$3,493	$3,834	$ 341
Chartered Banks	4,288	5,603	1,315
			1,656
Government Accounts	814	844	30
Public (residue)	6,624	6,796	172
Canada Savings Bonds	6,026	6,194	168
			$2,026

3.9 The inflationary impact of some 80% of the increase in federal Government debt being acquired by the banking system is obvious. What is not so apparent is that this table does not reflect the sale abroad (U.S., Western Germany and Italy) of the equivalent of $284 million of debt which is netted out under the public (residue) statistics.

3.10 During the calendar years 1967-69 inclusive, $9,860 million Canada Savings Bonds were presented for redemption. Four Savings Bonds campaigns were undertaken which produced sales of more than $10,460 million at a cost slightly in excess of $100 million. The resultant net increase in outstandings of Canada savings bonds of $600 million cost over 17% in underwriting and promotion fees. Few junior governments, no matter how desperate for funds, could afford such expensive money. We are by no means sure that Canadian taxpayers should be faced with such costs either.

3.11 Junior governments were unable to rely upon the

chartered banks, the central bank, or savings bonds campaigns to any great extent. They were helped by Canada and Quebec Pension Plan acquisitions but, as a result of the scramble for capital, had to bear the brunt of interest rate increases and exchange risks from borrowing abroad. We are pleased that the policies of credit restraint initiated last year by the Bank of Canada and by the federal Government are showing the first glimmerings of success. However, as Governor Rasminsky has pointed out it is still too soon for relaxation of restraint. In the 1969 Annual Report he said:

"The purpose of restraint is not, however, to slow down the economy for its own sake but as a means of slowing down the price and cost increase in order to provide a solid base for sustainable economic expansion. Policy will not achieve its objective if it is abandoned at the first sign of success, namely, as soon as the growth of the economy shows signs of deceleration. This is particularly the case if there are widely held inflationary expectations."

The tax proposals give bondholders relatively poor treatment compared to equity holders and thus the attractiveness of fixed income securities will tend to lessen unless structural yield changes take place. For example, under the terms of the proposals a taxpayer in the 40% tax bracket would pay $10 income tax in respect of a dividend of $100 from a "widely-held" Canadian tax-paying corporation whereas his tax liability in respect of $100 of bond interest would be $40. Similarly, a $100 gain on the sale of shares of a widely held corporation would attract a $20 tax, but on bonds the tax would be $40.

3.12 We would have hoped that tax reform might have included some proposals which would have facilitated borrowing for both the public and private sectors which traditionally have raised most of their requirements through the issuance of long term debt. Unfortunately, we find little that appears

likely to be helpful to the bond market in the White Paper, excepting possibly the amortization provisions which may, under some circumstances, minimize the impact of capital gains taxation.

3.13 We have referred in Appendix "A" to the bias toward further inflation (which is contrary to present policies of controlling inflation) and the apparent inevitability of less saving and higher consumption in the private sector. We anticipate that this will lead to a greater demand for capital which will not be available from either personal or corporate savings in Canada. In due course, upward pressure will be exerted on interest rates and in all probability greater reliance will have to be placed on obtaining non-resident savings. However, the proposed treatment of non-resident capital is less favourable than it has been and we expect that, in view of a less attractive investment climate, non-residents will require additional inducements to invest in Canada. If we are unable to attract sufficient capital, balance of payments difficulties can be envisioned which may result in pressures on our currency and, perhaps, foreign exchange controls or devaluation, leading to a further loss of confidence in the Canadian dollar and Canada. The ultimate outcome will surely be slower economic growth, which perhaps is inevitable in a consumer-oriented economy with high taxation.

3.14 It is, of course, possible to delay these events with stimulative fiscal and monetary policies but this would seem likely to revive inflationary pressures and the Canadian economy would have made a full circle with nothing gained by Canadians.

3.15 In view of the prevailing problems in the high grade

bond market, particularly for government borrowers, together with the adverse impact on taxpayers arising from higher debt service requirements*, we believe that it is essential that incentives be offered to investors to make the acquisition of government bonds more attractive. We recommend, therefore, that interest, up to a maximum of, say, $1,000 per annum on bonds issued by Canadian municipalities and provinces be taxed at a rate not in excess of 10% in the hands of individuals resident in Canada.

Summary of Economic Appraisal

3.16 For the various reasons set out above and in Appendix "A", we do not believe that the Government's general conclusion as to the economic effect of the proposals is likely to be accurate. In our opinion, the "modest impacts" and the "moderate" reduction in private saving and capital expenditures that are expected to result from implementation of the proposals would in fact be substantial enough to have a serious impact on economic growth and the "small . . . increase in public revenues" may well have been seriously underestimated.

3.17 We recognize that our conclusions must to some extent, be looked upon simply as matters of opinion. However, when these same opinions are shared not only by the Association and its member firms but also by individual investors, professional people, small businessmen and by many other segments of the economy in all parts of Canada, ranging from the resource industry, privately-owned utilities and banking institutions in the private sector to municipal and provincial organizations in the public sector, it must give responsible and interested citizens much cause for concern.

* According to the Budget Papers for 1970-71, public debt charges rose from $1,095 million in 1960 to $2,262 million in 1968.

3.18 One of the essential ingredients of a strong and viable economy is the confidence and optimism of its people as to future economic prospects. Any loss in confidence, such as that presaged by the public's criticism of the White Paper proposals, must in our view be regarded as harmful and for this reason, if for none other, we believe that those proposals which we consider to be the more fundamental must be rejected or substantially modified.

3.19 We recognize that may of our misgivings may be allayed by the assurance that the Government's expenditure policies would be so ordered that the anticipated increase in tax revenues under the White Paper proposals could be applied to alleviate the tax burden of those hardest hit by the proposals. However, in the absence of satisfactory assurances on this point, we believe that the public at large is justified in its concern as to the harmful effect of the proposed shift in the burden of tax -- especially so, having regard to the insatiable demands by each level of government for a continually increasing share of the nation's gross national product and to the lack of an established ceiling on the proportion of the gross national product that may be used for new or expanded government programs.

3.20 Failing satisfactory assurances that the tax reform proposals are not intended to produce one of the largest tax increases in Canadian history, the Association submits that any easing in the income tax burden of those in the low income groups must be accomplished, at least in part, by increased reliance on indirect taxation if the more harmful effects of the proposed tax shift are to be avoided.

2. FAIR DISTRIBUTION OF THE TAX BURDEN

3. 21 The primary goal stated in the White Paper is that the tax system should provide for "a fair distribution of the tax burden based on ability to pay".

3. 22 In determining the fairness of the proposals, it is important to bear in mind not only the incidence of tax but also the economic effect on inflation, savings flows and investment. Unless a fine balance is maintained between ability to pay on the one hand and willingness to work, save and invest on the other, any measures that may be introduced to achieve a greater degree of fairness must inevitably harm those who were intended to benefit by them. John Kenneth Galbraith, who is far from conservative in political persuasion, offered the following pertinent comments on the subject of redistribution of income:

"And it has become evident to conservatives and liberals alike that increasing aggregate output is an alternative to redistribution or even to the reduction of inequality." (The Affluent Society)

Thus, while we commend the Government's motives in easing the tax burden of low income earners, we believe that the relief afforded, small as it is, is likely to be eroded in a very short time by the effects of inflation and a slower rate of economic growth, unless certain other proposals are modified. Similarly, the introduction of some form of taxation on capital gains would unquestionably contribute to the fairness of the tax system. We believe, however, that the specific form of taxation proposed in the White Paper, combined with the present estate and gift tax provisions, would result in economic sluggishness which would be inequitable to all Canadians and would be felt most acutely by those in the lower income group.

3. 23 The White Paper includes several other worthwhile

proposals which are directed at achieving greater fairness in distributing the tax burden. These include the broadening of the tax base to include items such as unemployment insurance benefits and salaries of exchange teachers; the wider range of deductions for employees and the deduction for many of the so-called nothings.

3.24 Conversely, we believe that the White Paper proposals contain certain features which would be unfair, particularly with respect to the question of the ability to pay. For example, the deemed realization of gain or loss under the five year revaluation proposal could give rise to a liability for tax which the taxpayer may not be able to meet out of readily available funds and, in the event that he were obliged to liquidate part of his holdings, he would suffer a dilution of his interest in the business and perhaps even lose control of the business. Furthermore, the proposed roll-over provisions relating to corporate reorganizations appear unduly restrictive and there would undoubtedly be many circumstances in which tax would be payable in respect of "paper gains" resulting from such reorganizations long before the taxpayer was able to convert his profit into cash. The proposed withdrawal of the two-tier rate applicable to corporate income has provoked widespread concern which undoubtedly reflects the difficulty for smaller businesses to meet a further tax levy when cash is so scarce.

3.25 . Apart from the problems that may arise concerning an ability to pay, we have noted many other proposals which, as they are described in the White Paper, give rise to serious doubt as to their fairness. These include:

1. the proposed distinction in the tax treatment of income and capital gains depending on the form of ownership -- that is whether the corporation is closely-held or widely-held;

2. the anomalous treatment of gains realized by closely-held corporations on the sale of shares in widely-held corporations, resulting in a higher tax at the shareholder level than would have been payable if the shareholder had owned the shares direct; and
3. the proposal to tax the entire proceeds of sale of goodwill or mineral claims (subject to certain transitional provisions) even though these reflect values created prior to Valuation Day.

Finally, we would point to the income averaging provisions and the proposed disallowance of entertainment and convention expenses as signs of a high degree of insensitivity to fairness.

3. MODERN SOCIAL NEEDS

3.26 The recognition of modern social needs is stated to be the third goal or objective of the White Paper. The Association admits that it is uncertain what this objective implies.

3.27 The White Paper refers to the "demands and conditions" which strain to the limit the ability of governments and other public authorities to finance their activities. The statement is then made that the required tax reform "must further the proper development of this changing society".

3.28 These statements, when considered together with the expected increase in tax revenues under the White Paper proposals, might seem to imply that the Government has in mind the introduction of additional or expanded spending programs. However, various statements by the Minister of Finance subsequent to the publication of the White Paper indicate that this is not the Government's intention and that, if additional revenues do result, some reduction in tax may be expected. If this is the case, it is difficult to understand what is meant by the expression "modern social needs" and it is not possible to form an opinion as to whether the White Paper proposals would be an effective means of attaining this objective.

3.29 However, it is difficult to be optimistic about the possibility of future tax reductions even if the present Government were to announce the manner in which such reductions might be expected. Past experience suggests that it might be realistic to expect that, other things being equal, Government expenditures would rise to absorb any revenue increases if, in fact, such increases have not already been earmarked for new or expanded programs.

3.30 Canada is fast reaching the end of its financial

ability to provide additional unearned social services. This is in effect admitted in the White Paper which proposes that the top rate of personal tax should apply at the $24,000 income level. It is quite evident that there is a limit to any further increases in social expenditures and, having regard to the large number of taxpayers who would be removed from the taxrolls under the White Paper proposals, the Government must learn to close its ears to pleas for additional social services from non-contributors of revenue.

4. COMPLIANCE

3.31 The achievement of widespread understanding of, and voluntary compliance with, tax laws combined with enough detail to block loopholes is a goal having a number of facets which must be considered separately.

1. Widespread Understanding

3.32 Firstly, the White Paper must be looked at from the point of view of whether it will result in "widespread understanding" of tax law. It is generally accepted that existing income tax law is quite complex and it must be said that some of the White Paper proposals would result in simplification in certain areas. As against this, it seems clear that other proposals would inevitably require complex law and in this context we would mention the creditable tax provisions, various aspects of the taxation of capital gains, the income averaging provisions and the taxation of "passive" income earned outside Canada. Consequently we do not believe that the tax system which would result from the White Paper proposals would be more understandable than the one which we have at present.

3.33 In a sophisticated economy such as we have in Canada it is important that the tax system be flexible so that different situations may be treated in different ways. A "simple" tax system which would be understood by everyone would not serve adequately a diverse economy and would inevitably result in inequitable tax effects. Notwithstanding the complexity of the present system most taxpayers have little difficulty complying with those provisions of the law which govern their tax position.

2. Voluntary Compliance

3.34 Another aspect is said to be "voluntary compliance with tax laws". According to the White Paper, excellent voluntary compliance is already being obtained. We can see no reason to suppose that the level of compliance, already high, will be increased by the proposals and, we suspect that, the tendency will be the other way.

3.35 This would result from the possible effect of the proposals on the public's attitude to taxation. Voluntary compliance depends to a great extent on taxpayers feeling that the tax base is fairly established and that the rates are reasonable. Public reaction to the White Paper has indicated that many taxpayers object to its proposals, and this may well erode taxpayers' "morale", as reflected in willingness to comply voluntarily and completely with the law.

3.36 Undoubtedly there would be a somewhat greater degree of compliance in reporting taxable property transactions but little additional revenue will ensue since these are eventually assessed under present law. On the other hand, we foresee a significant degree of attempted tax avoidance in certain areas, e.g. with respect to gains on the disposal of property held for personal use, the deduction of entertainment expenses and the deemed realization of gains by persons leaving Canada. A tax which invites avoidance is inequitable to those taxpayers who comply.

3. Blocking Loopholes

3.37 Finally, while encouraging understanding and voluntary compliance by means of simplification, the proposals are also intended to provide detailed provisions to "block loopholes". The present system is not unsound and too much effort is directed

at "abuses" and "loopholes" such as surplus stripping, tax havens, expense account living and tax deferrals, which in our view are not widespread (less than 1% of revenues) nor beyond the power of the Department of National Revenue to control. Implementation of all the White Paper proposals would undoubtedly provide openings for new loopholes, and in the process of closing them fresh disputes would arise between taxpayers and tax officials, with accompanying delays in decisions due to lack of legal precedents. Those likely to be hurt most in this process would be the innocent and unsuspecting who would be unable to afford legal or accounting aid. Furthermore, some proposals have already been identified as being unworkable; a number are considered likely to create problems.

3.38 Despite the White Paper's wide scope, it is only a part of overall "tax reform". We have already had a tightening of some aspects of estate and gift taxation while further reforms, such as in respect of sales taxation and depreciation allowances, have not been drafted as yet. Changes in these latter respects could completely alter taxpayer views as to the equity of the present proposals taken in conjunction with the other changes.

5. ACCEPTABILITY TO THE PROVINCES

3.39 It is obvious from the reaction of certain provincial governments, such as Alberta, British Columbia, Ontario and Saskatchewan, that they consider the White Paper proposals to be unacceptable. If the system proposed in the White Paper is rejected by these provinces, and perhaps also by others, we must have serious doubts whether the present proposals, which are not adopted by all of the provinces, can successfully be put into effect. Apart from the increased tax collection costs and the additional administrative problems that would result from differing federal and provincial tax systems, there can be little doubt that the taxpayer would be the victim of the inequities that must inevitably follow from such a multilateral tax structure.

3.40 The growing proportion of national tax revenue and expenditure responsibilities assumed by the provinces in recent years is clear evidence of the necessity for federal-provincial unity in the approach to tax reform. The direct administration of social welfare programs such as education, health, housing and transportation are primarily provincial functions and, in the Association's view, much of the direct responsibility for levying any increased tax revenues to meet these needs must be in the hands of each province. As concerned observers of federal-provincial relations, we view with misgivings the federal Government's tendency to promote social policies in areas of provincial concern, albeit with assurances of financial support from the federal Government.

ALTERNATIVE SUGGESTIONS

4.1 In common with most other Canadians, we believe that the present income tax law is deficient in many respects and that some amendments are warranted. For this reason, we agree in principle with many of the changes proposed in the White Paper including:

1. The broadening of the tax base to include in income such items as unemployment insurance benefits and salaries of exchange teachers;
2. The allowance of more liberal deductions for employed persons and of child care expenses;
3. The elimination of the special benefits now available to members of the armed forces;
4. The reduction of the top marginal rate of personal income tax to approximately 50%;
5. The proposed changes in the taxation of co-operatives, caisses populaires, credit unions and non-profit organizations; and
6. The allowance of a deduction for such of the so-called "nothings" as underwriting expenses, discounts on the issue of bonds and transfer taxes.

4.2 Each of these changes would add to the fairness of the tax system although it is noted that the Government may not have been entirely consistent in some of these areas. For example, there appears to be no valid reason for including unemployment insurance benefits in the tax base and at the same time failing to include items such as family allowances, strike pay and workmen's compensation pay. Similarly, it is difficult to understand the Government's rationale in taxing the investment income of non-profit organizations which are now exempt from

tax under Section 62(1)(i) of the Income Tax Act and allowing other tax-exempt organizations to continue to be exempt from tax on business profits as well as investment income.

4.3 We also believe that some form of taxation of capital gains is appropriate and that some easing in the tax burden of those in the lower income group is desirable -- either by means of increased basic exemptions or by an appropriate tax credit.

4.4 On the other hand, having regard to the harmful economic effects that are likely to result from the proposed treatment of capital gains and losses, the steeply graduated rates of personal income tax up to the $24,000 income level, the inadequacy of the averaging provisions and the integration of personal and corporate income taxes, we are not convinced that such drastic reform is desirable in these areas.

Rate Schedule Changes

4.5 The Association believes that the steeply graduated rates of personal tax proposed in the White Paper should be moderated so as to alleviate the burden of the tax on the middle and upper middle-income groups and bring their income taxes more into line with prevailing rates in the United States. If revenue needs cannot be contained to achieve both this and the proposed easing in the tax burden of lower-income groups within the framework of the income tax system, we suggest that consideration be given to increased reliance on indirect taxes as a means of obtaining the necessary increased tax revenues. The economic consequences that would follow from an extension in the use of indirect taxes, such as sales or consumption taxes, should be more easy to predict, and would probably be less harmful at this stage in the country's development, than the system proposed in the White Paper.

4.6 In advancing the suggestion that indirect taxation should be considered as a possible means of accomplishing some of the necessary tax reforms, we are not unmindful of the regressive nature of these taxes. We submit, however, that much of the regressiveness can be avoided if appropriate exemptions are allowed for certain non-discretionary expenditures such as food and shelter and if the tax is extended to certain services as well as to commodities. Alternatively, a refundable tax credit may be allowed against income taxes for sales tax paid on non-discretionary expenditures up to a prescribed maximum.

4.7 We would also remind the Committee that indirect taxation, in one form or another, is becoming increasingly important as a source of revenue in most economically advanced countries of the world. In our view, this source should be more fully exploited in preference to any other measures which might adversely affect economic development.

4.8 We also believe that the full reduction of the top marginal rate of personal income tax to approximately 50% should take effect immediately upon implementation of the tax reform proposals and should not be spread over a four year period as presently proposed.

Averaging Provisions

4.9 The proposed averaging provisions do not provide adequate relief for those with widely-fluctuating incomes and, in fact, provide no relief where there is a substantial reduction in income from previous years. We suggest that a general block averaging provision should be introduced with appropriate limitations as to the circumstances in which these provisions could be applied.

Capital Gains and Losses

4.10 While we do not believe that the taxation of capital gains is wholly desirable for a country such as Canada which continues to be dependent on non-resident capital to finance its economic growth, we agree with the Government's conclusion that some form of taxation is appropriate to ensure that the burden of tax is more fairly distributed and to lessen some of the uncertainties under the present law.

4.11 However, the form of tax must be such that it would make some allowance, direct or indirect, for the effect of inflation and would not seriously impair the savings habits of Canadians nor limit Canada's ability to attract non-resident capital. We envisage that this tax would have the following features:

1. A distinction would be drawn between
   (a) short term gains and losses, which are usually of a speculative nature and contain little or no element of inflation, and
   (b) long term capital gains and losses.
   Short term gains and losses would be includable in income in full but only one-half of any long term gains or losses would be taken into account in computing taxable income.
2. Gains (or losses) would only be "taxable" when realized (or sustained), subject to the introduction of deemed realization provisions that would apply on death or when property is "gifted"-- assuming that death taxes and gift taxes are withdrawn, as discussed below. These deemed realization provisions would obviate the necessity for the five year revaluation rule proposed in the White Paper.

3. If taxpayers are to be taxed on deemed gains and losses when they give up their Canadian residence (and we recognize that this may be necessary to ensure that the system is workable), provision should be made to enable taxpayers who leave the country temporarily to defer liability for tax until such time as they dispose of their assets. In addition, the application of the rule must be restricted to avoid discouraging skilled and trained persons from establishing temporary residence in Canada.
4. Taxpayers would be entitled to "value" any marketable securities which they owned on Valuation Day and which they had acquired in an arm's length transaction within, say, five years immediately preceding implementation date at
   (a) market value, or
   (b) where their actual cost was greater than market value, at the lower of cost or the net amount realized on ultimate sale of the securities.

   Such a rule, while not wholly justifiable from a theoretical point of view, would help allay one concern which many people have expressed, viz. that, if market prices as a whole or with respect to any particular security were unduly depressed on Valuation Day, taxpayers could find themselves ultimately subject to tax under the White Paper proposals on a "gain" which simply represented a recovery, or partial recovery, of a loss that existed on Valuation Day because of depressed market prices. In the case of bonds and debentures, the measurement of gain

or loss by reference to "actual cost" rather than by reference to "amortized cost", as is now proposed, would simplify matters considerably both for taxpayers and for the administration.

5. Provision would be made for the use of an "alternative basis" of "valuing" assets other than marketable securities, that are owned at valuation date in order to minimize valuation problems on Valuation Day and to avoid some of the inequities that might otherwise result if values were unduly depressed on that date. Consideration should be given to the adoption of a basis similar to that proposed by the Royal Commission on Taxation or to that used in the United Kingdom when a tax on capital gains was introduced there some years ago. In each case, the alternative basis involved the proration of the actual profit or loss over the period of time the asset was held and only the portion allocated to the period following implementation date was includable in income.

6. The law would contain reasonably generous roll-over provisions which would ensure that gains would not be taxed unless there is a true realization. For example, the roll-over provisions in respect of a gain realized on the sale of a principal residence should not be limited to circumstances where the taxpayer changes jobs. Of greater importance, the system should be so structured that it does not impede corporate reorganizations which are motivated by valid business reasons and procedures

should be established for obtaining advance rulings that would be binding on the tax authorities.

7. Adequate provision should be made for the carry-over of losses.

4.12 We submit that the treatment proposed in the White Paper with respect to the taxation of the proceeds of sale of goodwill and the allowance of a deduction for the cost of goodwill purchased after implementation date is anomalous. We suggest that gains or losses on the sale of goodwill should be taxed in the same manner as other capital gains or losses and that no deduction should be allowed in respect of the cost of purchased goodwill

1. until it is disposed of, when the cost would be taken into account in computing the gain or loss on disposition, or
2. until it could be established that it ceased to have any value.

Partnership Option

4.13 The Association believes that the proposal allowing closely-held corporations to elect to be treated as a partnership is desirable but suggests that consideration should be given to the removal of the restriction denying the right to use the partnership option where there are non-resident shareholders.

Corporate Rate of Tax

4.14 The Association recognizes that the present dual rate of corporate tax has certain shortcomings in that (a) it gives certain taxpayers an inequitable advantage over others who are unable to incorporate, (b) it has led to some tax avoidance, and (c) it is available to every corporation whether or not it requires assistance in financing capital expansion. For these reasons, we agree with the Government's conclusion that some amendment is desirable.

4.15 However, it is our view that the Government has failed to give adequate recognition to the financing problems which confront small businesses in their development stages in proposing to eliminate the lower rate of corporate tax without providing a suitable alternative solution to this problem -- and, in this regard, we believe that the partnership option proposed in the White Paper does not provide adequate relief.

4.16 Various alternative proposals will no doubt be put forward to the Committee on this matter including the following:

1. that small corporations be entitled to special capital cost allowance rates and/or special allowances in respect of increased investment in inventories and accounts receivable, thereby allowing them some deferment of tax during expansion periods; or
2. that small corporations which can justify a need for funds to finance expansion be entitled to defer payment of tax on a certain portion of their taxable income.

The Association favours the first of these alternatives but admits that the problem offers no easy solution. We would impress upon the Committee, however, the need for some relief and, in this regard, we would suggest that consideration should also be given to extending this benefit to unincorporated businesses, especially to those which would be affected by the proposals withdrawing the privilege of using the cash basis of reporting income.

Integration of Corporate and Personal Income Tax

4.17 The Association is of the view that some form of integration of personal and corporate income tax is desirable if the various anomalies, inequities and compliance problems inherent in the system proposed in the White Paper can be eliminated. However, having regard to the harmful economic consequences that are likely to result from adoption of the White Paper proposals, especially in today's economic climate, and having regard to the costs involved ($230 million by the fifth year of the new system - based on 1969 incomes), we believe that implementation should be deferred. In the meantime, further study should be given to the concept of integration to determine whether the present proposals can be substantially improved upon - failing which the concept should be rejected. A more detailed discussion of integration is contained in Appendix "C".

4.18 The existing system of taxing corporate distributions is admittedly imperfect and has given rise to elaborate and intricate plans to minimize the impact of double taxation. In this context, it is noted that the conflict between taxpayers and the taxation authorities has now reached a stage where genuine business transactions are being impeded because of possible, although by no means certain, tax effects.

4.19 However, the Association believes that the present dividend tax credit, though imperfect, has served its purpose reasonably well and that many of the current difficulties would disappear if the personal and corporate income tax rates were brought into line (as suggested in the White Paper proposals) and if capital gains were subject to tax. We suggest, therefore, that consideration be given to the retention of the 20% or a more generous dividend tax

credit, at least for the time being, and to the introduction of a measure such as that proposed in the White Paper to permit withdrawals of pre-implementation surplus at a tax cost of 15%.

Repeal of the Estate Tax Act

4.20 The repeal of the Estate Tax Act should take place in conjunction with the introduction of a tax on capital gains which would require a deemed realization on death, modified by provisions for orderly liquidation of estate assets. We regard the Estate Tax Act, as it stands at present, as being extremely harmful to the Candian economy in that it depletes pools of capital, reduces the incentive to save and encourages the sale of Canadian business abroad. At the same time the collections of revenue which result from the estate tax are comparatively insignificant, having averaged slightly in excess of $100 million for each of the last several years.

4.21 We have suggested that, for purposes of the tax on capital gains, the making of an inter-vivos gift be treated as a deemed realization. In conjunction with this, the gift tax provisions of the Income Tax Act should be repealed.

4.22 As a transitional measure, we envisage that substantial personal estates as at Valuation Day would be subject to a future tax levy at the time of a subsequent deemed realization resulting from death or gifting.

Bond Interest

4.23 For the reasons described in paragraph 3.15, we recommend that interest up to a maximum of, say, $1,000 per annum received by individuals resident in Canada on bonds issued by a Canadian municipality or province be taxed at a rate not in

excess of 10%.

Tax Avoidance by International Operations

4. 24 This is said to be a fairly serious problem but we are not convinced that it cannot be curtailed by the law as it stands at present. Certainly, the attitude of the Department of National Revenue of late indicates that its officials are of the opinion that abuses can be prevented without far reaching new legislation. The White Paper, in dealing with this problem, apparently envisages the introduction of provisions similar to those in Sub-part F of the United States Internal Revenue Code. This legislation is regarded, in the United States, as so complicated as to be unworkable and serious efforts are being made to have it withdrawn. We most strongly advise against the introduction of similar legislation in Canada and suggest that "tax haven" abuse be countered by use of the law as it stands at present.

Non-resident withholding taxes

4. 25 Regardless of the existence of treaties with foreign countries, the Association suggests that the maximum rate of tax applicable to interest payments should not exceed 15%. In short, we do not believe that a rate of withholding tax greater than 15% should be applied (especially if it is to be borne by the lender rather than by some foreign treasury) in that it would discourage necessary capital investment from non-treaty countries.

Entertainment Expenses

4. 26 The arbitrary manner in which the government proposes to avoid any possibility of abuse in this area must surely be modified. We are not aware of widespread evidence of abuse; no doubt the existing power of the Department of National Revenue would appear to be adequate to provide effective safeguards.

Mining and Oil Industries

4.27 We feel strongly that the mineral industry, which has made tremendous contributions in the post-war years in developing Canadian natural resources and the resultant supporting secondary industry, as well as making possible improved balance of payments on merchandise account should not be discouraged from continuing its programs of exploration and development. Nor do we feel that non-resident risk capital should be impeded by "tax reform" from flowing into Canada. Similarly, Canadian capital should be encouraged to seek new mineral and petroleum discoveries in Canada rather than abroad.

4.28 One of the greatest problems to be combatted is the unevenness of employment which continues to waste our manpower resources and tends to limit our productive output. The First Annual Review of the Economic Council of Canada issued in December 1964, under the Chairmanship of John J. Deutsch, outlined these problems at length in chapter 8. It was pointed out, among other things -- that primary industries in Canada had greatly increased our economic output and were most important to our balance of payments position because of large and growing exports. They also facilitated the creation of secondary industry in the areas where they operated resulting in expanded employment opportunities. This, in turn, required increasing and more diversified skills on the part of labour and, in order to maximize production potential, education and retraining facilities were encouraged, and labour should be convinced that greater mobility on its part would result in higher standards of living. This concern for the "supply side" of the labour situation is of the utmost importance. Appendix "D" quotes Economic Council views as well as those of Louis Rasminsky.

4.29 In Finance Minister Benson's recent Budget we were pleased to note that the scope of the financial provisions for the Department of Regional Economic Expansion, which is attempting to combat regional disparities, was enlarged. We feel that, since Canada has one of the fastest growing labour forces in the industrial world, every effort should be made to further the efforts of the Federal Government and the various Regional Boards of the Provinces. In our view, it would be imprudent to limit in any way, labour training and mobility and we, therefore, suggest that more generous expenses be allowed to labour moving from one part of the country to a job in another and that income earned by labour undergoing legitimate training in programs such as provided by the Adult Occupational Training Act should not be taxed.

Other Matters

4.30 The White Paper contains proposals dealing with Trusts, Mutual Funds, Pension Plans and Retirement Savings Plans and we are uncertain as to the effects of the suggestions and comments. Rather than making any recommendations of our own we are deferring to those with greater expertise in these fields from whom the Committee undoubtedly will be hearing.

APPENDIX "A"	ASSESSMENT OF THE ECONOMIC EFFECTS OF THE PROPOSALS FOR TAX REFORM
APPENDIX "B"	ESTIMATED GROSS NEW CANADIAN FINANCING
APPENDIX "C"	INTEGRATION OF CORPORATE AND PERSONAL INCOME TAXES
APPENDIX "D"	EXTRACTS FROM ECONOMIC COUNCIL OF CANADA FIRST ANNUAL REVIEW - CHAPTER 8

APPENDIX "A"

ASSESSMENT OF THE ECONOMIC EFFECTS OF THE PROPOSALS FOR TAX REFORM

The following assessment of the probable effects of the tax reform proposals on specific aspects of Canada's economy is submitted in support of the Association's general conclusion with respect to their economic impact.

The Bias Toward Inflation

The White Paper proposes to shift the burden of taxation from those with a greater propensity to spend and consume to those with a greater propensity to save. To us, this inevitably means a decrease in savings accompanied by a rising demand for consumer goods which, had it occurred last year, would have aborted attempts of the Government and the Bank of Canada to contain inflationary pressures.

We are also experiencing a demographic change which has resulted, in Canada, in a lower average age of the working population due to rapidly increasing numbers of new entries into the labour force. We believe that the young are essentially spenders and borrowers, not savers, and this will further dislocate the balance between consumption and savings.

A nation of spenders, in its addiction to consumption must expect higher prices if the "supply" side of the equation (the creation of greater production facilities) is neglected. We believe that in recent years, our economy has moved too rapidly toward consumption and that we now require incentives to save and invest - not disincentives. There are clear implications that since the private sector will save less, Canada will require more capital from abroad. The Government should remember that there is a world-wide shortage of capital, that what is

available is extremely fluid and that no one is obliged to invest in Canada. Non-resident capital will seek an attractive investment environment and will be discouraged by lack of incentives and heavy taxation.

As a corollary to potential capital shortages in a consumer oriented economy, interest rates will tend to rise and the value of our currency may become suspect.

Other proposals may cause those affected to pass on higher taxation in the form of higher prices. Rents and professional fees readily come to mind and undoubtedly other prices would be influenced.

The difficulties encountered in recent months in attempting to contain inflation have convinced us that a very slight change in fiscal policy would soon reverse any success which we may now have achieved in curbing inflation. This Committee showed its awareness of this danger in its recent report on interest rates by recommending that there be no relaxation of monetary and fiscal policy until there is a distinct deceleration in the rate of increase in costs and prices, a principle which we endorse without qualification.

Incentives to Work and Save

The conclusions advanced in the White Paper relating to the effect of the proposals on incentives to work and save are as follows:

1. That the proposed reduction of the top marginal rate to 51.2% should have a beneficial effect on the incentive of those who earn high incomes
   (a) to choose additional work rather than additional leisure, and
   (b) to save rather than to consume.

2. That the proposed increases in marginal rates up to the $15,000 or $17,000 level may have a modest adverse effect on the incentive of those below this level to work overtime or more extensively or to seek advancement by extra effort or training.

We submit that the White Paper's commentary on this issue is misleading as it deals only with the effect of the proposed rate schedule changes on incentives and does not refer to the harmful effects of some of the other proposals.

The Association agrees with the suggestion in the White Paper that the principal consideration affecting the willingness of those who earn high incomes to choose additional work rather than additional leisure is the marginal income tax rate. For this reason, we welcome the proposed reduction of the top marginal rate to the 50% range. We are disappointed, however, that the Government chose not to reduce the rate immediately upon implementation of the tax reforms but decided that it should be reduced only gradually over a four year period. This decision cannot be justified either on the grounds of equity or on the grounds of fiscal need and it is our considered opinion that the full reduction should take effect immediately upon implementation so as to avoid the disruptive influences that might otherwise occur during the transitional period, viz., the tendency to postpone business and investment decisions or the receipt of taxable income until the rate reduction becomes fully effective in order to minimize income taxes.

It must also be recognized that the present Government cannot guarantee that the proposed decreases in the top marginal rates will be put into effect. They may be intended at this time, but other unforeseen pressures may make it

expedient for the government of the day not to carry them into effect.

The Association disputes the implication that the proposals may also have a beneficial effect on the propensity of those who earn high incomes to save rather than consume. We firmly believe that the proposed changes in the treatment of capital gains and losses, coupled with the gift tax and death tax provisions now in force, would have a serious impact on the willingness of the so-called "wealthy" to save, and that this would more than offset the favourable effect that would result from a reduction in the top marginal rate. For example, reference to the Government's supplementary papers concerning the effect of the personal income tax changes reveals that the net additional burden on those in the $25,000 to $50,000 income level would be approximately eight times the relief afforded them through the reduction in the top marginal rate.

We believe that may other citizens, such as retired persons, may also be discouraged from accumulating further savings or from attempting to preserve as much capital as they now do, by the prospect of double taxation of their estates, i.e. the estate taxes and succession duties that would be payable on death and the income tax which their estate or beneficiaries would have to pay on any gains realized on the sale of their assets.

In our view, the impact of these proposals on capital formation in Canada could indeed be serious, having regard to Canada's pressing need for capital, and we accordingly urge this Committee and the Government to give their most earnest consideration to the suggestions which we have offered in this Brief on the subject of capital gains and losses, estate taxes and gift taxes.

The Association agrees in principle with the Government's conclusion that the White Paper proposals will have some adverse effect on the incentive of those with incomes between, say, $10,000 and $17,000 to work overtime or more intensively. The effect could be somewhat greater than that indicated in the White Paper because of the widening of the tax base to include capital gains and other items which are not taxable under present law.

Rate of Savings

This Committee and the Government should carefully consider that personal savings in 1969 (really before the release of the White Paper and its punitive tax proposals) declined by $116 million after four consecutive years of increase. As a percentage of GNP, personal savings declined from 4.9% in 1968 to 4.3% in 1969. It is possible that a trend toward a lower rate of saving is already under way as a result of rising taxation and inflation. We have little doubt that this trend will be accentuated by the White Paper proposals.

One of the officials of the Department of Finance, Mr. R. B. Bryce, who undoubtedly played an important part in drafting the White Paper expressed the view at the recent Canadian Tax Foundation Conference that "many of (the) faults of the old system .... had an important economic significance". The notes from which he spoke continued as follows:

> "They favoured those who saved - and invested their savings - and accumulated wealth
> note these major examples:
> (a) no capital gains tax
> (b) effectively no tax on savings accumulated in life insurance policies and companies

(c) the ability to accumulate income, especially dividends, in private corporations at rates lower, even much lower, than personal tax rates - and eventually realize on it with relatively little or no tax

(d) the low rate of tax on the first $35,000 of corporate income applicable to all corporations whether or not there was economic justification in particular types of cases - extensively used for the accumulation of capital within small corporations, frequently in groups of corporations associated, in fact if not in law

correction of these major faults in the old system was bound to impinge upon savings, and on the retention and channels of investment of savings."

Changes have already been made in respect to life insurance and estate and gift taxation. It is now proposed to tax capital gains, both realized and unrealized, and to increase the income tax rates for many "savers". The combined effect is that individuals are offered little encouragement to accumulate capital through deferring consumption.

It is also our view that there would be a reduction in corporate savings due to such factors as -

the elimination of the lower corporate rate of tax,

the change in the treatment of inter-corporate dividends,

the modifications affecting the resource industries,

and increased dividend payouts to avoid staledating under the integration proposals.

With respect to the last-mentioned factor, the Government's view is that the reduction in corporate savings would be offset

by an increase in personal savings. On the contrary, our experience indicates that income from securities is normally spent and not saved. It follows that if corporations are less able to retain profits for investment purposes, they will require relatively more outside capital than at present and we do not believe it will be available in Canada from individual savings in adequate size.

Migration

Since the publication of the White Paper proposals, the disparity in the personal income tax burden of the average Canadian and his U. S. counterpart has been widened with the enactment of the U. S. Tax Reform Act of 1969 which reduced personal income tax rates in the United States. As a result, the Canada-U. S. income tax comparison on which the Government based its conclusions is misleading.

This comparison is also subject to the following further criticisms:

1. The U. S. tax shown in the Government's examples is based on the rates applicable in New York State, which has one of the highest income taxes in the United States, whereas the Canadian tax represents the amount payable in those provinces which have the lowest income taxes.
2. The U. S. calculations were based on the assumption that the itemized deductions for taxpayers with income in excess of $10,000 ($12,000 in the case of a married taxpayer with two dependents) would equal 5% of their income plus the amount of their state income taxes. This allowance may represent the

> average deduction claimed by all U. S. taxpayers for all allowable deductions such as property taxes on one's home, sales and gasoline taxes imposed at the state level, mortgage interest, other interest expenses, charitable donations and medical expenses. However, it is probably much less than the average deduction that would be available to those taxpayers who may emigrate to the United States, having regard to the age and income level of these taxpayers.

A more detailed study of the comparative burden of income taxes in Canada and the United States, based upon taxation statistics in each country, is contained in the January-February, 1970 issue of the Canadian Tax Journal. This study compares the income taxes payable by residents of Ontario and Manitoba (being the provinces with the lowest and highest income tax burdens respectively in 1969) with the income taxes payable by residents of Nevada and Vermont. The former state had no income tax in 1969 and the latter was chosen partly because it had a fairly high income tax and partly because the system was closest to that used in Canada.

This study, as adjusted to reflect Canada Pension Plan contributions and U. S. Social Security taxes, reveals the following disparities between Canadian and U. S. income tax costs for a married person with two dependent children under 16:

Income level	Tax payable under White Paper Proposals	Annual savings if resident in U. S. A. — Before U. S. Tax Reform: Vermont	Before U. S. Tax Reform: Nevada	After U. S. Tax Reform: Vermont	After U. S. Tax Reform: Nevada
A. Ontario resident					
$ 8,500	$1,155	$ (175)	$ 23	$ 35	$ 201
12,000	2,180	25	394	301	637
17,000	3,508	44	685	437	1,039
28,000	7,692	524	1,932	1,261	2,614
B. Manitoba resident					
$ 8,500	1,248	(82)	116	128	294
12,000	2,361	206	575	482	818
17,000	3,802	338	979	731	1,333
28,000	8,347	1,179	2,587	1,916	3,269

According to this study, the disparity between Canadian and U. S. income tax costs would be much more material than that indicated in the White Paper and, contrary to the conclusion reached in the White Paper, large differences could occur below the $20,000 income level. For example, at the $12,000 level, the income tax savings that would be obtained by moving to the United States could range from approximately 15% to 30%.

It is recognized that income tax considerations have not, in the past, been a material factor in motivating Canadians to migrate to other countries. The predominant factors are the expectation of higher living standards and a better environment. However, in view of the magnitude of the prospective tax differential, as shown above, the Association believes that tax considerations could become an increasingly important factor in emigration and that the proposed rate schedule must be modified to ease the impact of tax on skilled persons who may be

attracted to the United States - presumably those in the $10,000 to $25,000 income group. Inasmuch as governments in Canada are now spending approximately 20% of all tax revenues on education, it would not be sensible to risk the loss, through emigration, of highly educated and trained Canadians. The Government's suggestion that Canadian salaries be increased to meet U. S. competition for those who may be attracted to the United States is sheer economic heresy.

Also, if we expect to have economic growth, we will require those with skills and imagination from other countries. We feel that, while the authors of the White Paper have considered this, the matter has been dismissed too lightly.

In evaluating the effect of the proposals on migration the Committee should also keep in mind that the proposed imposition of tax on any "deemed" capital gains at the date on which a person ceases to reside in Canada may have a harmful effect on the interchange of knowledge and experience between this country and our neighbours, particularly the United States.

For example, a Canadian resident might be reluctant to accept a temporary appointment of, say, two or three years duration in some other country if he was likely to be subject to a substantial amount of tax at the date of his departure on his "deemed" capital gains, including perhaps a "deemed" gain on a home which he decided to retain for his personal use on his return to Canada. Similarly, non-residents may be unwilling to accept temporary assignments in Canada because of the prospect of tax on "deemed" gains at the date of their departure from Canada.

Foreign Investment in Canada

The Association has come to the conclusion that

Canada's ability to attract foreign capital is likely to be seriously impaired if White Paper proposals are legislated. We are unable to accept the statement that "Non-resident investors in Canada should not be substantially affected by the tax changes proposed --". The proposals are based upon Canada's ability to obtain favourable tax treaties with more countries throughout the world than we have now. We believe the basis upon which Canada will be promoting treaties with other countries will be unacceptable to most governments and that this, in itself, will have an adverse effect, not only on our ability to attract additional foreign capital, but to retain that already here. Items at issue include taxation of non-residents by Canada of capital gains both realized and in some cases unrealized and higher withholding taxes (generally 25% compared with 15%).

Effect on Business Investment

Mineral Industries

The White Paper recognizes the desirability of continuing to provide mineral industries with some incentives not generally available to other industries. We do not feel particularly qualified to assess the reaction either of Canadians or non-residents to the proposals which would reduce these incentive benefits. However, we are concerned that non-residents may decide to invest their risk capital in other countries, as have some Canadian companies in recent years. Aside from possible effects on the growth of the Canadian mineral industry, we are disturbed about probable diminished ability to eliminate regional disparities and the future adverse impact upon balance of payments which may result from a slower rate of growth of mineral exports.

Other Industry

It seems likely that other types of industry may also be

adversely affected by the White Paper proposals. Small business, which for more than 20 years has enjoyed lower taxation of its profits, may be unable to finance growth as a result of higher taxation unless special new incentives are provided. While we believe that the dual rate of taxation should be eliminated on the grounds that it is not justified either for large companies or for small companies with no significant growth in capital requirements, we nevetheless believe that special incentives through tax deferrals or other means should be provided for those companies which can show need. In this context it should be remembered that small companies have few ways of acquiring additional capital. In the normal sense, capital markets are not available to them and they are largely dependent upon their bankers for additional financing for expansion purposes. Then too, most large companies usually are dependent upon a vast number of small suppliers and distributors.

The disallowance of expenses for attending conventions, entertaining customers or clients, etc. would have a serious impact on the Canadian hotel and restaurant business. Moreover with fewer such facilities in either urban or resort areas, Canadians would tend to holiday out of the country and we will be less able to attract non-resident tourists, thereby increasing our deficit balance of payments position on travel account.

Impact on Balance of Payments on Capital Account

The White Paper suggests that the "balance of international payments would be affected by a number of proposed changes but on the whole it should be modestly improved". This concept seems to be based on the assumption that there would be no widespread sell-off by

non-residents of their holdings of Canadian equities, despite discriminatory treatment, and that non-residents would continue to invest in Canadian debt instruments. We are not at all sanguine as to the soundness of these assumptions particularly if satisfactory tax treaties are not concluded. When the less hospitable nature of the Canadian investment climate becomes apparent, non-residents may withdraw their investments from Canada and be less likely to make new acquisitions of Canadian securities or to invest directly.

APPENDIX "B"

ESTIMATED GROSS NEW CANADIAN FINANCING
$ millions

	Canadian Funds				U. S. Funds	Other Funds	Total
	Due in 5 years or less	Due in over 5 years	Term Option	Equity and Equity Oriented Debt			
CANADA							
1966	1,265	385	–	–	–	–	1,650
1967	910	575	450	–	–	–	1,935
1968	1,860	550	–	–	100	162	2,672
1969	1,005	125	350	–	–	–	1,480
PROVINCES							
1966	15	723	100	–	388	–	1,226
1967	182	757	41	–	650	–	1,630
1968	48	620	–	–	520	228	1,416
1969	60	160	313	–	695	273	1,501
MUNICIPALITIES**							
1966	–	357	–	–	124	–	481
1967	–	316	–	–	155	–	471
1968	–	270	–	–	99	22	391
1969	–	249	–	–	71	43	363
CORPORATIONS							
1966	6	795	–	495	347	–	1,643
1967	54	712	6	469	380	–	1,621
1968	53	476	8	511	636*	29	1,713
1969	31	158	276	999	614	19	2,097
TOTALS							
1966	1,286	2,260	100	495	859	–	5,000
1967	1,146	2,360	497	469	1,185	–	5,657
1968	1,961	1,916	8	511	1,355*	441	6,192
1969	1,096	692	939	999	1,380	335	5,441

* Excludes one large commitment for $500 million with delivery spread over several years.
** Not readily broken down into term categories.

N. B. Above estimates are based on commitment dates. Excludes bonds and bills due in less than one year, term bank loans, Savings Bonds and Canada and Quebec Pension Funds acquisitions.

The table above, which compares gross Canadian financing during 1969 with the three previous years, reflects a marked change in financing methods. For instance, there was a sharp reduction in standard long term conventional borrowing maturing in over five years, which was replaced by large increases in term-option borrowing, equity features and a continued reliance on the U. S. and European markets. It

was apparent that the requirements of the federal Government were lower, as might have been expected with a restrictive fiscal policy and an anticipated budgetary surplus. There was also a small decline in municipal financing, which may have been caused more by an inability to conform to the type of issues acceptable to the market, than by the intentions of municipalities. However, provincial financing was somewhat higher than the average for the past three years and there was undoubtedly a substantial increase in short term provincial paper outstanding. Neither municipalities nor the provinces received any material help from the chartered banks through increased loans or security acquisitions. Corporation financing showed a much heavier dependence on equity or equity oriented issues.

In addition to the data in the table, there was a large increase in short term corporate paper outstanding and bank loans to business, as indicated by the most recent available statistics, which showed an increase during the year ending December 31, 1969 of about $575 million and over $1 billion respectively. Clearly, despite one of the most prolonged restrictive credit policy periods ever experienced during peacetime in Canada, most of those who required capital were able to obtain it one way or another. Perhaps this provides a partial answer for the unusual length of the time lag involved before policy started to become effective.

APPENDIX "C"

INTEGRATION OF CORPORATE AND PERSONAL INCOME TAXES

One of the most far-reaching reforms in the White Paper, both from an economic and a tax structural point of view, is that relating to the taxation of corporations and their shareholders. According to these proposals, corporate and personal income taxes would be integrated, subject to the 2-1/2 year "stale-dating" rule, by treating part or all of the tax paid by the corporation as a prepayment of the tax payable by its shareholders on dividends or other distributions received from the corporation.

It has apparently been assumed that the entire amount of income tax paid by closely-held corporations is borne by the shareholders and it is accordingly proposed that the shareholders of these companies would, in general, obtain credit for the full amount of corporate income tax paid. On the other hand, only 50% integration is proposed for widely-held corporations on the assumption that part of the corporate income tax paid by these companies is effectively passed on to customers, suppliers and/or employees.

The Association recognizes that the incidence of corporate tax, as between shareholders, customers, etc., may vary from one corporation to another. However, we submit that the dividing-line drawn in the White Paper is arbitrary and completely unrealistic. Moreover, we believe that any dividing-line that may be drawn would prove equally unrealistic and that the only workable alternative would be to treat all corporations in the same manner.

The only acceptable alternatives appear to be to allow

either 100% or 50% integration for all corporations or to retain the existing dividend tax credit system, with or without modification.

The Government has rejected the concept of full integration for all corporations presumably on the grounds of equity, revenue needs and economic considerations. The Association believes that the proposals for partial integration are also unacceptable for a number of reasons; examples of which are briefly noted below:

1. The difficulties involved in determining the amount of creditable tax that passes to shareholders would lead to a number of compliance problems and may prove to be virtually unworkable in some circumstances. According to the technical paper which the Minister of Finance released on March 19 last, the mechanisms for tracing creditable tax appear, in theory, to be relatively straightforward. However, this paper does not reflect the complexities that would arise as a result of the proposal not to allow credit for any provincial taxes levied at a rate in excess of 10% and as a result of the difference in determination of creditable tax attaching to dividends paid out of foreign source income as opposed to dividends paid out of Canadian source income.

2. Corporations which do not have sufficient creditable tax to cover all dividend payments will encounter a considerable amount of difficulty in attempting to deal equitably with shareholders if there are several classes of outstanding stock, each with differing payment dates.

3. The complexity of the proposed creditable tax system could make it virtually impossible for resident Canadian

investors or their investment counsel to assess the return on many prospective investments.

4. The proposed imposition of tax on intercorporate dividends might necessitate a substantial re-organization of Canadian business to the extent that dividend-paying subsidiaries have insufficient creditable tax to cover dividend payments and the parent company is unable to use the partnership option because of the existence of minority share-holders or because the subsidiary is a widely-held corporation.

5. The 2-1/2 year "staledating" rule would frequently necessitate the use of stock dividends if share-holders are to obtain full benefit of a corporation's creditable tax. This would give rise to undesirable additional bookkeeping, legal and other costs--especially if the payment of stock dividends involved the distribution of fractional shares.

6. The lack of creditable tax which could be passed on to shareholders of companies which have taken advantage of available tax incentives such as fast capital write-offs and depletion could effectively negate the benefit of such incentives and might impose an investment bias against such companies which are often the young growing companies.

7. Non-residents of Canada will not be concerned with the amount of creditable tax in a corporation. Shares of new and growing Canadian companies and of inter-national Canadian companies which have comparatively small amounts of creditable tax would therefore be relatively more attractive to non-residents than to

> Canadian residents. The discrimination against international companies would be even more pronounced if dividends are deemed to be paid first from foreign earnings instead of from Canadian earnings which may carry full creditable tax.

The workability of the integration proposals is also entirely dependent upon all provinces agreeing to the system and adopting it as part of their own system. If any of the provinces chose to adopt a modified form of integration or reject it entirely, the administrative problems could prove overwhelming. In addition, if the provinces refuse to apply the tax which they now receive (directly or indirectly) under the Public Utilities Income Tax Transfer Act to enable the shareholders of privately-owned electric, gas or steam utilities to take advantage of the creditable tax provisions, there would undoubtedly be a bias against investment in the shares of these companies.

The Association concludes that the only acceptable alternative is, therefore, the dividend tax credit system on a basis similar to that now in effect but with consideration given to increasing the amount of the dividend tax credit to, say, 25%; thus placing it on a similar footing to the effect under a 50% integration system as proposed in the White Paper. If considered appropriate, the credit may be changed to a "refundable" tax credit so that a refund of tax would be paid to the extent the credit exceeds the shareholder's tax otherwise payable.

APPENDIX "D"

EXTRACTS FROM ECONOMIC COUNCIL OF CANADA FIRST ANNUAL REVIEW - CHAPTER 8

"The removal of obstacles to desirable labour mobility is a chief function of labour market policy. For example, effective labour mobility is indispensable to minimizing the duration of unemployment when workers are displaced from their jobs. Shortening the duration period of unemployment can contribute significantly to economic growth and stability by increasing the supply of labour needed to match demand. Inadequate labour mobility, by impeding the flow of labour at a time of high demand, results in shortages and bottlenecks which produce upward pressures on production costs." . . . .

". . . a declining industry and a depressed locality often go hand in hand. Under these circumstances, a breakdown in labour mobility may not only prolong problems of the locality, but may also result in expanding industries elsewhere being deprived of needed manpower. There is thus a two-fold adverse effect on the national economy: the growth of the national product is retarded by unused manpower resources bottled up in a depressed industry or locality; and, at the same time, inflationary pressures may be created as a result of labour shortages in expanding industries or localities. Rigidities of this nature act as a deterrent to growth and handicap a country's competitive ability and its balance of payments position. Furthermore, since idle manpower must also be supported, this imposes an additional cost on the nation as a whole."

Governor Rasminsky has also been concerned with the supply side of the labour situation and in an address to the Chamber of Commerce of Montreal in November, 1955 he pointed out:

"We must, of course, continue to aim at maintaining a level of demand for goods and services sufficient to realize the increases in output of which the economy is capable, but I think we should also be increasingly concerned with the supply side of the equation, with the factors which bear directly on our capacity to produce. Basically, the main sources of continued economic growth on the supply side are the increases in the labour force and the increases in productivity or output per man which we can hope to achieve."

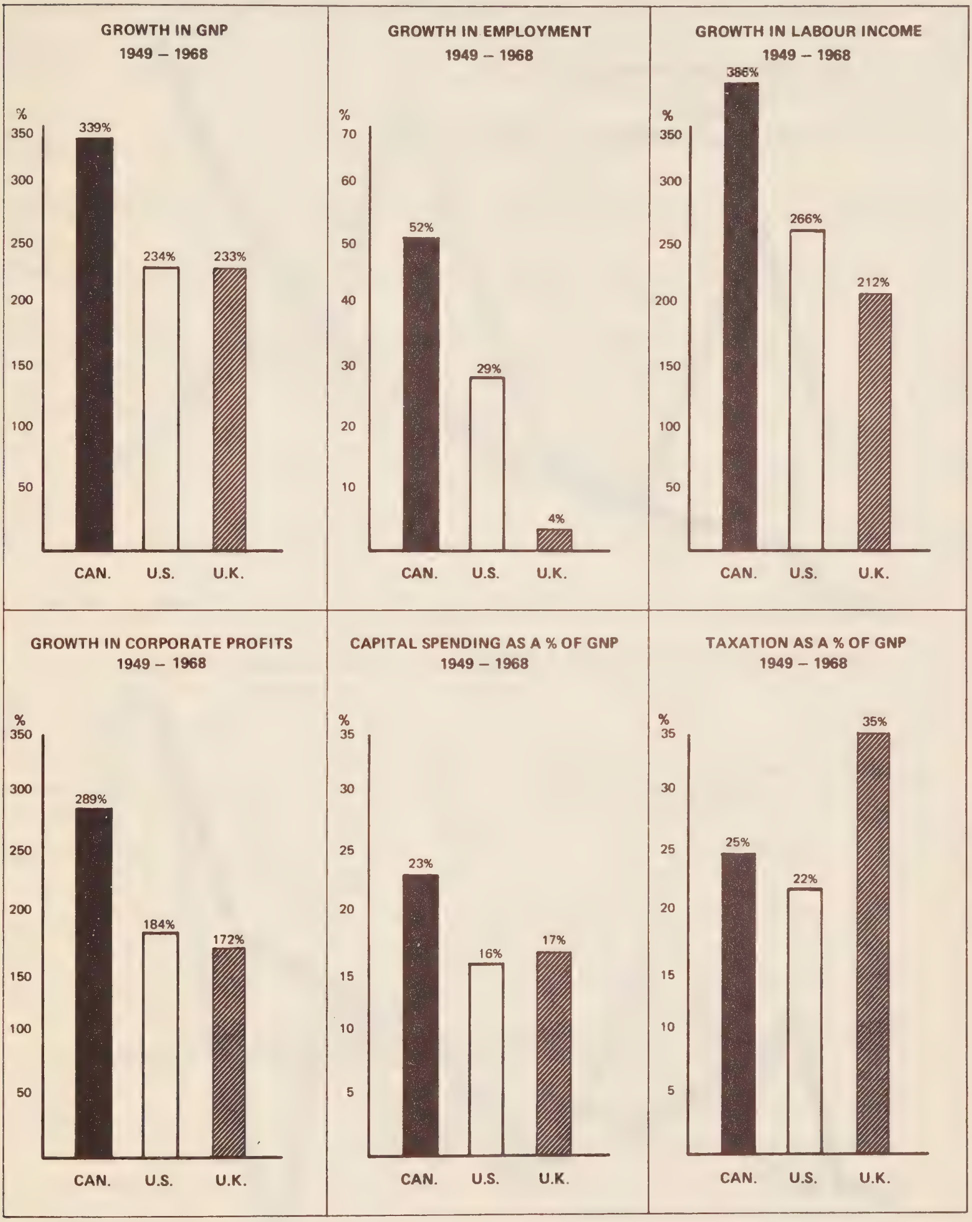
In another address before the Halifax Board of Trade in February 1966, the Governor stated:

"In order to avoid undue pressure on our price and cost structure and thus on our competitive position when the economy is operating at very high levels, we need to place greater emphasis on policies which are directed to the supply side of the picture. This means giving greater attention to the education and training of our manpower as well as other efforts to promote our industrial efficiency and our adaptability to changes in demand and technology."

That the supply problem still concerns the Governor is indicated by the following statement from the Annual Report of the Bank for 1969:

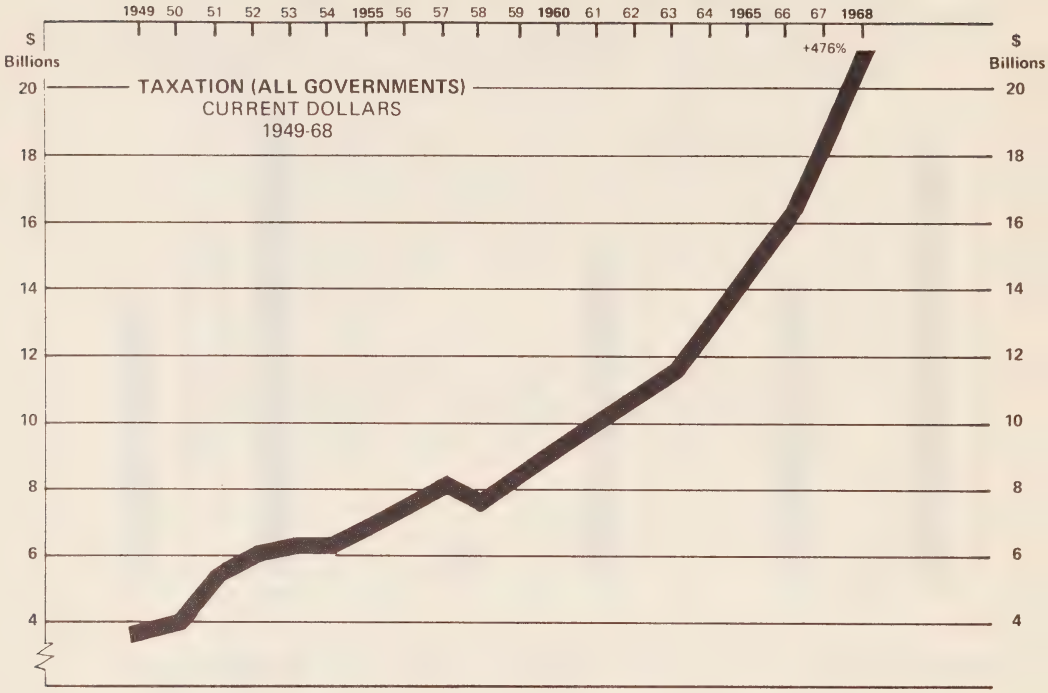
" 'Supply' policies designed to increase the efficiency and mobility of our resources (such, for example, as retraining and the development of labour skills) are indeed of fundamental importance to the long-run performance of the economy, and much emphasis has properly been placed on them by governments."

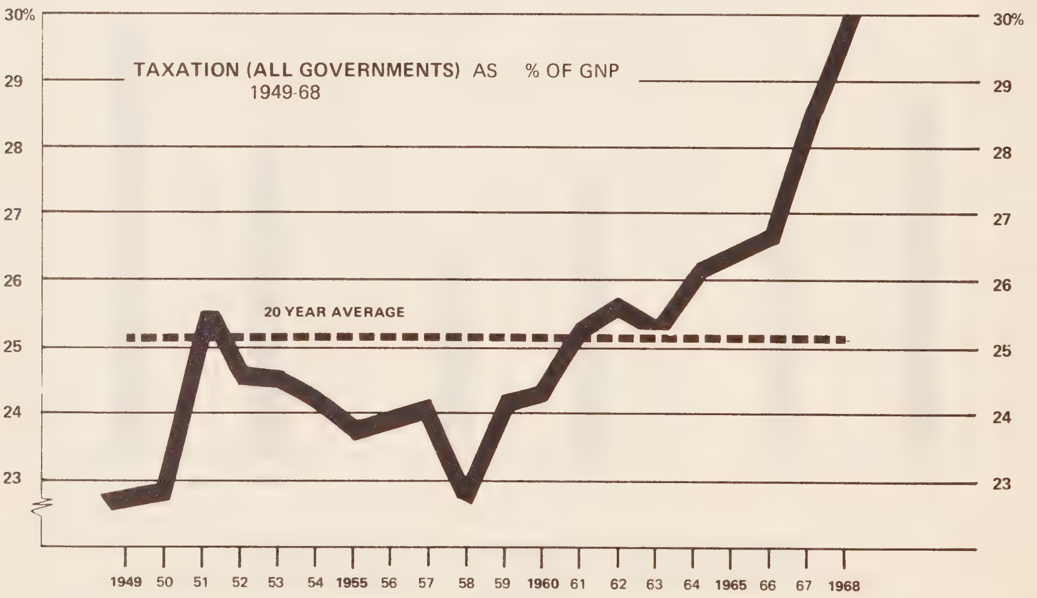
CANADA'S ECONOMIC PROGRESS COMPARED WITH THE UNITED STATES AND THE UNITED KINGDOM - 1949-68



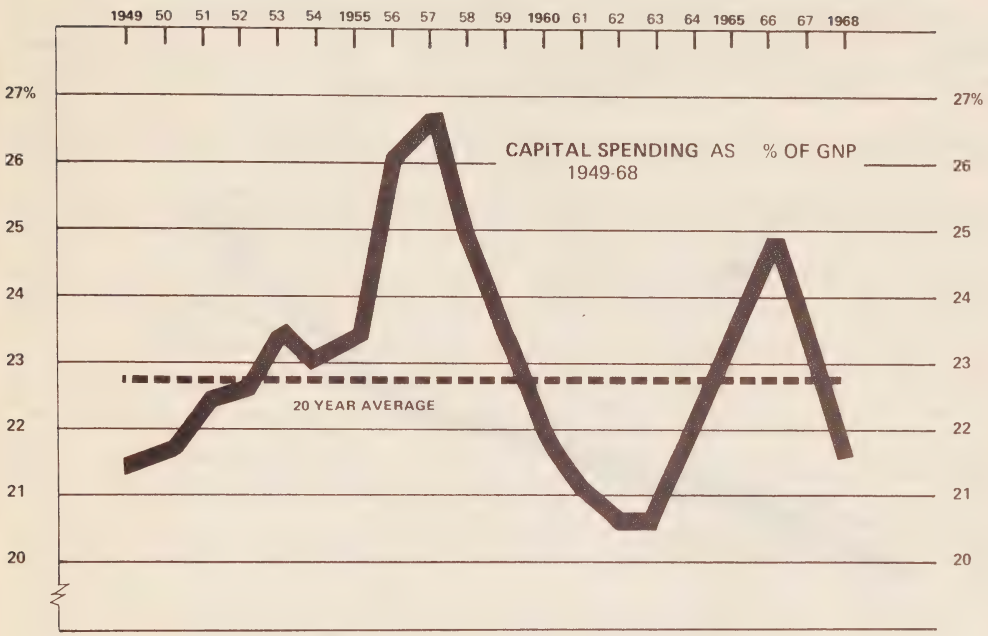
SUBMISSION OF THE INVESTMENT DEALERS' ASSOCIATION OF CANADA ON THE GOVERNMENT WHITE PAPER "PROPOSALS FOR TAX REFORM"
JUNE, 1970

CANADIAN TAXATION - 1949-68

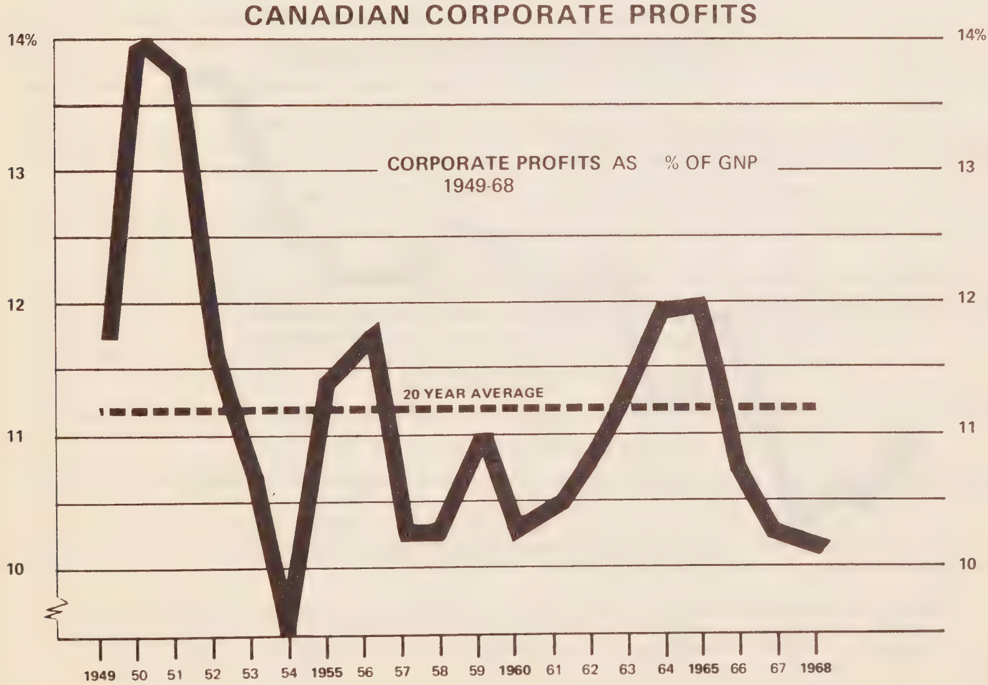




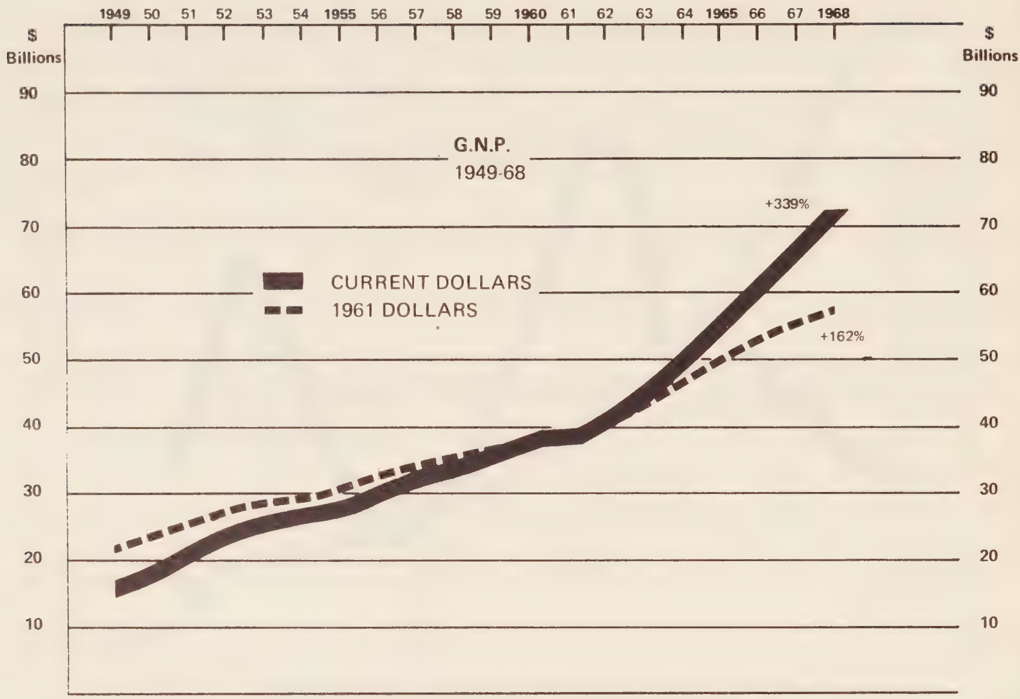
CANADIAN CAPITAL SPENDING



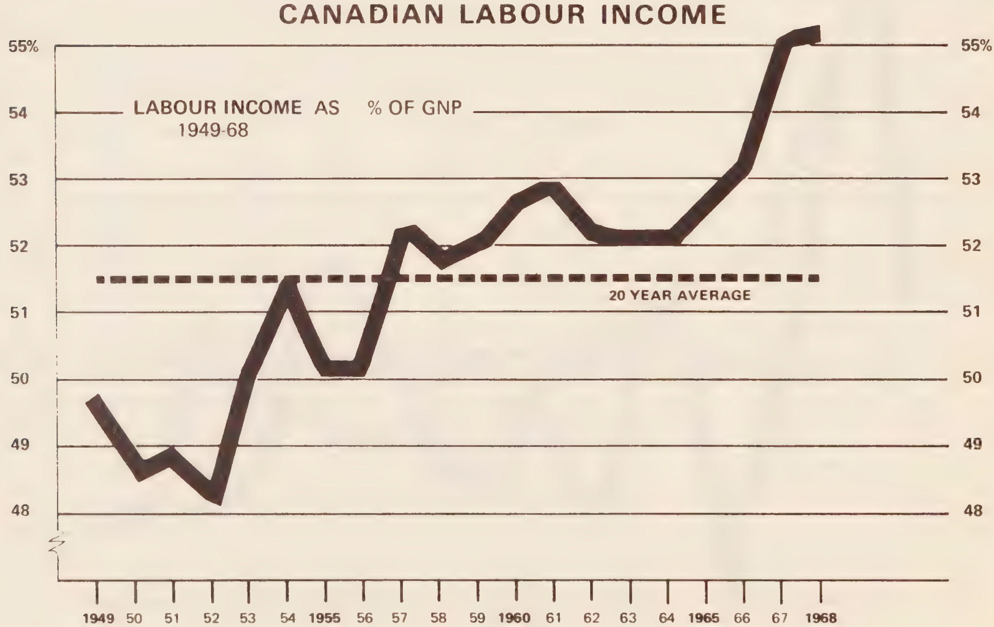
CANADIAN CORPORATE PROFITS



CANADIAN G.N.P.



CANADIAN LABOUR INCOME



APPENDIX "H"

NAME: INVESTMENT DEALERS ASSOCIATION OF CANADA

SUBJECT: White Paper Proposals

Analysis of Appendix "G" by Senior Advisor

This Brief is submitted by the Investment Dealers Association of Canada, an association of 140 member firms, serving some 750,000 investors.

The Brief is mainly concerned with the effect of the White Paper proposals upon the savings of Canadians and the consequent reduction in available capital for economic growth.

The summary to the Brief states the Association's general conclusions which are:

(1) While a number of proposals are desirable in principle, those relating to the taxation of capital gains, integration and the shift in the tax burden are likely to have harmful economic effects.

(2) Furthermore, inadequate consideration has obviously been given to the financing problems of small business and to the problem of regional and resource development.

(3) In the post-war years, Canada's economic growth has been impressive under existing policies; thus changes should be undertaken with caution. It is our view that the existing tax system would continue to serve the country well with less drastic modifications than those suggested in the White Paper.

(4) Some signs of deterioration have appeared in Canada's economic scene in recent years. One major contributing factor has been the disturbing rate of growth in public expenditures; therefore, action must be taken to restrict the proportion of GNP appropriated to the public sector.

The summary to the Brief also sets out alternative suggestions, which are fully developed in the section of the Brief labelled "Alternative Suggestion". (Pages 30 to 42 of the Brief).

The Brief proper is divided into the following parts:

(1) Introduction (Pages 1 to 6 of the Brief).

This part sets out the organization of the Association and deals with primary objects of tax reform. It concludes with the following paragraph:

"Experience over the years throughout the world has indicated that conflicts in relation to these national objectives arise only on how policy should be implemented. This seems to be principally a problem of allocating priorities in such a way as to maximize the desired aims. It should be pointed out that on occasion, benefiting from hindsight, the priority list has not always been too well selected. To use adjectives from the extracts from the Porter Report quoted above, policy in Canada has not always been "well-thought-out", "deliberate" and "co-ordinated". Rather it may have been "wrongly conceived", "haphazard" and "unco-ordinated"." (Page 6 of the Brief).

(2) General Conclusions (Pages 7 to 12 of the Brief).

This part states that a number of proposed amendments are obviously desirable. It however, concludes that other proposals are not desirable. These are:

a. Those relating to capital gains and losses.
b. Integration of personal and corporate income taxes, and
c. The shift in tax burden, the rate schedule changes and the inadequate relief afforded by the averaging provisions.

In addition this part deals with what it believes to be the inadequate consideration to:

a. The effects of the elimination of the lower rate of corporation tax.
b. The impact of the changes on the extractive industries.
c. The inequities that could arise as a result of the proposed changes in the taxation of trusts and,
d. The unnecessary complexities that would result from the introduction of measures similar to those contained in Sub-part F of the United States Internal Revenue Code.

Paragraph 2.8 of this part points out:

"It is evident that the Canada Goose has been laying larger golden eggs more frequently than some of her friends. Therefore, we do not think her feeding habits or her environment should be changed too much. In other words, we are strongly opposed to abrupt, "radical", far-reaching tax "reform" which could be detrimental to our present social and economic achievements and future aims". (Paragraph 2.8, pages 8 and 10 of the Brief).

And again Paragraph 2.12:

"Moreover, we believe strongly that most Canadians want a chance to experience rising standards of living with greater discretion over the spending of their own earnings and are not "demanding" more government services. The shocking increases in government spending must be stopped and to this end we recommend that a Royal Commission be appointed to examine and confirm the necessity of limiting government spending to a level not to exceed a fixed percentage of GNP." (Paragraph 2.12, pages 11 and 12 of the Brief).

(3) Economic effects:

This part questions whether adequate studies have been made upon economy.

(4) Fair-distribution of the Tax Burden.

The part points out in Paragraph 3.22:

"Thus, while we commend the Government's motives in easing the tax burden of low income earners, we believe that the relief afforded, small as it is, is likely to be eroded in a very short time by the effects of inflation and a slower rate of economic growth, unless certain other proposals are modified". (Paragraph 3.22, page 21 of the Brief).

and

"Similarly, the introduction of some form of taxation on capital gains would unquestionably contribute to the fairness of the tax system. We believe, however, that the specific

form of taxation proposed in the White Paper, combined with the present estate and gift tax provisions, would result in economic sluggishness which would be inequitable to all Canadians and would be felt most acutely by those in the lower income group." (Paragraph 3.22, page 21 of the Brief).

and

"Conversely, we believe that the White Paper proposals contain certain features which would be unfair, particularly with respect to the question of the ability to pay. For example, the deemed realization of gain or loss under the five year revaluation proposal could give rise to a liability for tax which the taxpayer may not be able to meet out of readily available funds and, in the event that he were obliged to liquidate part of his holdings, he would suffer a dilution of his interest in the business and perhaps even lose control of the business. Furthermore, the proposed roll-over provisions relating to corporate reorganizations appear unduly restrictive and there would undoubtedly be many circumstances in which tax would be payable in respect of "paper gains" resulting from such reorganizations long before the taxpayer was able to convert his profit into cash. The proposed withdrawal of the two-tier rate applicable to corporate income has provoked widespread concern which undoubtedly reflects the difficulty for smaller businesses to meet a further tax levy when cash is so scarce." (Paragraph 3.24, page 22 of the Brief).

(5) Modern Social Needs.

This section points out the Association is uncertain as to what the authors of the White Paper implied by this objective.

(6) Compliance.

This part questions whether some of the proposals, if implemented, would be of sufficient simplicity that the average taxpayer could comply with the law. In particular, it mentions the creditable tax provisions, various aspects of the taxation gains,

the income averaging provisions and the taxation of "passive" income earned outside Canada.

This part points out:

"This would result from the possible effect of the proposals on the public's attitude to taxation. Voluntary compliance depends to a great extent on taxpayers feeling that the tax base is fairly established and that the rates are reasonable. Public reaction to the White Paper has indicated that many taxpayers object to its proposals, and this may well erode taxpayers' "morale", as reflected in willingness to comply voluntarily and completely with the law." (Paragraph 3.35 page 27 of the Brief).

(7) Acceptability to the Provinces.

(8) Alternative Suggestions:

In this part the Association list those proposals of the White Paper with which it is in agreement.

It then points out in paragraph 4.2 certain inequities which the proposals would create.

It then lists those of the proposals which the Association believes should be changed. These are:

a. Rate schedule changes.

The proposed rates should be moderated to alleviate the burden of tax on the middle and upper middle income groups. The suggestion is made that indirect taxation might be considered as an alternative.

b. Averaging provisions.

The suggestion is made that a general block averaging provision should be introduced, with appropriate limitations as to the circumstances in which these provisions could be applied.

c. Capital gains and losses.

The statement is made that the Association does not believe a capital gains tax is desirable for Canada. If such a tax must be introduced then:

1. distinction should be made between short terms and long term gains and losses.
2. capital gains should only be taxable when realized.
3. allowance should be made when there is a departure from Canada of a temporary nature.
4. value should be determined at cost if it is higher than value of valuation day.
5. alternative values should be allowed for assets other than securities.
6. fuller provisions should be made for roll-overs when there is not a true realization.
7. adequate provision should be made for carry-over of losses.

(9) Partnership option.

The Brief submits that considerations should be given to the removal of the restriction which denies this right when there are non resident shareholders.

(10) Corporate rate of tax.

The Brief points out that various proposals will:

"Various alternative proposals will no doubt be put forward to the Committee on this matter including the following:

a. that small corporations be entitled to special capital cost allowance rates and/or special allowances in respect of increased investment in inventories and accounts receivable, thereby allowing them some deferment of tax during expansion periods; or

b. that small corporations which can justify a need for funds to finance expansion be entitled to defer payment of tax on a certain portion of their taxable income.

The Association favours the first of these alternatives but admits that the problem offers no easy solution. We would impress upon the Committee, however, the need for some relief and, in this regard, we would suggest that consideration should also be given to extending this benefit to unincorporated

businesses, especially to those which would be affected by the proposals withdrawing the privilege of using the cash basis of reporting income." (Page 37 of the Brief).

(11) Integration of corporation and personal income tax.

The Brief states that the Association believes that the present dividend tax credit, though imperfect, has served its purpose reasonably well and that many of the current difficulties would disappear if the personal and corporate income tax rates were brought into line (as suggested in the White Paper proposals) and if capital gains were subject to tax. We suggest, therefore, that consideration be given to the retention of the 20% or a more generous dividend tax credit, at least for the time being, and to the introduction of a measure such as that proposed in the White Paper to permit withdrawals of pre-implementation surplus at a tax cost of 15%". (Pages 38 and 39 of the Brief).

(12) Repeal of the Estate Tax Act & Gift Tax Provisions.

The Brief suggests that with the introduction of a tax on capital gains, the Estate Tax Act should be repealed. It is also suggested that for purposes of tax on capital gains, inter-vivos gifts should be treated as deemed realizations, and concurrently the gift tax provisions of the Income Tax Act should be repealed.

(13) Bond Interest.

The Brief recommends therefore, that interest, up to a maximum of, say, $1,000 per annum on bonds issued by Canadian municipalities and provinces be taxed at a rate not in excess of 10% in the hands of individuals resident in Canada. (Paragraph 3.15, page 19 and 39 of the Brief).

(14) Tax Avoidance by International Operations.

The Brief strongly advises against the introduction of legislation similar to that in Sub-part F of the United States Internal Revenue Code and suggests that "tax haven" abuse can be countered by use of the law as it stands at present.

(15) Non resident Withholding Taxes.

The Brief submits that a withholding tax should not exceed 15% regardless of the existence of treaties with foreign countries. A higher tax would discourage necessary capital investment from non treaty countries.

(16) Entertainment expenses.

"The arbitrary manner in which the government proposes to avoid any possibility of abuse in this area must surely be modified. We are not aware of widespread evidence of abuse; No doubt the existing power of the Department of National Revenue would appear to be adequate to provide effective safeguards."

(17) Mining and Oil industries.

(See pages 41 and 42 of the Brief).

The attention of the Committee is drawn to the following comments.

a. "It is evident that the Canada Goose has been laying larger golden eggs more frequently than some of her friends. Therefore, we do not think her feeding habits or her environment should be changed too much. In other words, we are strongly opposed to abrupt, "radical", far-reaching tax "reform" which could be detrimental to our present social and economic achievements and future aims."

(Paragraph 2.8, pages 8 and 10 of the Brief).

b. "Moreover, we believe strongly that most Canadians want a chance to experience rising standards of living with greater discretion over the spending of their own earnings and are not "demanding" more government services. The shocking increases in government spending must be stopped and to this end we recommend that a Royal Commission be appointed to examine and confirm the necessity of limiting government spending to a level not to exceed a fixed percentage of GNP."

(Paragraph 2.12, pages 11 and 12 of the Brief).

c. "We are not happy with the implication that the Government, which has frequently proven itself to be inept and extravagant in its spending, presumes to be able to make better use of funds than the private sector. We also wonder at the Government's rationale in interfering, seriously or otherwise, with economic growth or productivity or to cause any reduction in saving and capital expenditure. Surely equity and neutrality in the tax system are not worth the risk of slower economic growth over the longer term." (Paragraph 3.2, page 13 of the Brief).

d. "The White Paper contains some analysis of the expected economic consequences that would follow from implementation of the proposals but the discussion in many areas is vague and inconclusive and deals only with generalities." (Paragraph 3.3, page 13 of the Brief).

e. "The tax proposals give bondholders relatively poor treatment compared to equity holders and thus the attractiveness of fixed income securities will tend to lessen unless structural yield changes take place. For example, under the terms of the proposals a taxpayer in the 40% tax bracket would pay $10 income tax in respect of a dividend of $100 from a "widely-held" Canadian tax-paying corporation whereas his tax liability in respect of $100 of bond interest would be $40. Similarly, a $100 gain on the sale of shares of a widely held corporation would attract a $20 tax, but on bonds the tax would be $40." (Paragraph 3.11,page 17 of the Brief).

f. "The present system is not unsound and too much effort is directed at "abuses" and "loopholes" such as surplus stripping, tax havens, expense account living and tax deferrals, which in our view are not widespread (less than 1% of revenues) nor beyond the power of the Department of National Revenue to control. Implementation of all the White Paper proposals would undoubtedly provide openings for new loopholes, and in the process of closing them fresh disputes would arise between taxpayers and tax officials, with accompanying delays

in decisions due to lack of legal precedents."

(Paragraph 3.37, pages 27 and 28 of the Brief).

This Brief does not lend itself to the preparation of the usual summary of present law, White Paper proposals and principal points of the Brief.

APPENDIX "I"

COMMENTS
of
UNION CARBIDE CORPORATION
on
CANADIAN WHITE PAPER

Union Carbide Corporation (UCC), a New York corporation, conducts business operations in the States of the U. S. and through affiliated companies in 30 foreign countries in the following major product areas: chemicals, plastics, industrial gases, metals, carbon products and consumer products; Union Carbide Canada Limited (UCCL), an affiliated company, conducts business operations in Canada generally in the same major product areas enumerated above. The net book value of fixed assets of this affiliate exceeds C$110,000,000, and it has annual sales exceeding C$184,000,000. The value of UCC's investment in UCCL is substantially in excess of its investment in any other country outside the U. S. and Puerto Rico. From the inception of operations in Canada through 1964, UCC owned 100% of the equity investment in its affiliates operating in Canada. In 1964, in conformity with apparent policy of the Canadian Government, UCCL, with UCC's express approval, sold to unrelated Canadian investors an issue of its equity securities, resulting in 25% of total equity in this affiliate being held by such unrelated Canadian investors.

The management of this Corporation has reviewed the

extensive proposals for tax reform contained in the White Paper recently issued by the Canadian Government. We recognize that all tax systems should be continuously reviewed and improved and modified from time to time in light of changing national objectives, priorities and economic conditions. We further appreciate the time, effort and study which have gone into the development of the present White Paper.

As a non-resident of Canada, we would not presume to comment on those proposals which deal primarily with taxation of Canadian residents and entities and other internal matters. However, as indicated, this Corporation has a very substantial investment in Canada which we hope will not only be conserved but greatly expanded in the future. We therefore wish to present the following comments on the draft proposals as they would appear to affect this Corporation from an investment standpoint:

I. <u>Taxation of Gains in Widely-Held Companies</u>

This proposal would appear to subject UCC to taxation every five years on paper gains in its investment in UCCL even though there has been no realization of such gains, and in the circumstances UCC would not be able to deduct any unrealized losses. While we express no opinion on the proposal to introduce a capital gains tax on realized gains, we are deeply concerned by this unusual proposal of taxation of paper gains. This proposal could have very serious consequences to this Corporation as well

as to other non-resident investors.

The proposal to tax unrealized gains proceeds on the assumption that the holdings of such shares are readily marketable. This assumption of marketability is not correct in the case of a controlled block. The marketability of a controlled block depends on two factors:

1) ability of the market to absorb, and
2) the legal requirements imposed on the holder before it may market such controlled block.

Under and by reason of (1) and (2) above the holder of a controlled block is at a disadvantage.

Before UCC could legally dispose of any but nominal amounts of its holdings in UCCL, it would be necessary for UCC to prepare and file a prospectus or a statement of material facts for the approval of the appropriate security authorities in Canada or the United States, or both countries. In addition the requirements of any stock exchanges will have to be met. Of course, private placement, if such investors under these conditions could be found, would not make it necessary to meet the requirements of the securities authorities. However, UCC holds 7,500,000 shares of UCCL. If we assume an increase in price for these shares per year between valuation and revaluation date of $1.00 per year, the deemed realization or gain would amount to five times 7,500,000 shares or $37,500,000.00 and the tax exposure in

relation thereto would be $9,375,000.00. The burden of finding this amount of tax money would be well nigh impossible under market conditions as we know them.

As you are aware, the U. S. affords U. S. taxpayers a foreign tax credit for taxes paid to foreign countries provided: (1) foreign tax is an income tax under U. S. concepts; and (2) the tax credit in any year is limited in amount to the U. S. tax on foreign income for such year.

With respect to the proposed tax, there is a serious question whether it is an income tax under U. S. concepts, as taxation without realization is not in accord with such concepts. Furthermore, there would be no related income for U. S. tax purposes in the year of payment of the proposed tax and therefore under the credit limitation referred to above, it might be impossible to obtain the credit even though we assume the proposed tax is an income tax. While there is some question as to whether the proposed tax can be imposed on UCC under the present U. S.-Canada Tax Treaty, the provisions of this Treaty were written without such a tax in context and therefore the Treaty may not offer any protection to U. S. investors.

It is noted that this proposed tax does not apply to closely-held companies. The Canadian Company (UCCL) was a closely-held company as defined in the White Paper until it complied with Government policy by making available a degree of Canadian

ownership in affiliated companies operating in Canada. The position in which UCC now finds itself by reason of the proposals contained in the White Paper is an unduly harsh consequence of its compliance with Government policy.

A number of other questions arise in this area:

(1) The market value of a publicly traded stock fluctuates widely by virtue of factors completely unrelated to the intrinsic value of such stock. Accordingly, taxation at any given valuation date is most unrealistic in the absence of actual realization of any gains.

(2) Assume that a tax has been paid, would there be a refund of tax to a non-resident investor if the stock drops in value on a subsequent valuation date? If we assume that the ownership of these shares of UCCL by UCC is the only asset in Canada of UCC giving rise to potential income tax liability other than withholding tax any losses on deemed or actual realization in respect of those shares is lost and accordingly while a deemed or actual realization producing a gain to UCC would be subject to tax, no offset would be available in the event of a loss.

The nature of the proposed tax is such as to encourage sales and liquidation of investments in order to provide funds

for payment of tax. In the alternative, it would encourage a U. S. majority stockholder to strip off accumulated earnings and profits as dividends currently, an action which has precise results under existing U. S. tax law. Both of the foregoing approaches would amount to repatriation of capital investment funds from Canada and would not necessarily be in the best interests of the Canadian companies involved, and it is submitted would not be in the Canadian national interest.

II. Mobility of Management and Technical Personnel

One of the proposals in the White Paper would impose a tax on a Canadian resident when his residence is terminated, as though he had sold all his assets prior to departure. With respect to a U. S. citizen, this proposal can result in intolerable double taxation inasmuch as he probably could not credit such taxes in the U. S. for the same reasons stated above and for the additional reason that his foreign income would be much less (i.e., probably salary only) than a corporation operating internationally. A host of other problems are raised as to the value of his assets for tax purposes, e.g., stock options, vested or accrued rights under pension and retirement and profit sharing plans, and property values of assets.

UCC has a continuing flow of technology running to its Canadian affiliate which is essential to keep its operations competitive and up to date at all times. To effectively transfer

and convey such technology requires the assignment of U. S. technical personnel to Canada for protracted periods as well as Canadian personnel to spend protracted periods in U. S. locations. The net effect of this proposal would raise a very severe obstacle in obtaining necessary management and technical personnel in Canada.

III. Tax Withholding Rates

In connection with the Canadian policy of encouraging Canadian ownership in affiliated companies operating in Canada, an incentive was granted under which the Canadian withholding tax on dividends to non-resident shareholders of companies with a certain degree of Canadian ownership was reduced to 10%. The White Paper does not indicate whether this rate of withholding will be continued or whether it will be increased to the proposed 15% for treaty countries or 25% for non-treaty countries. We respectfully urge that the 10% withholding rate be retained.

IV. Non-Resident-Owned Investment Corporations

It is our understanding that it is proposed to increase the tax on non-resident-owned investment companies from 15% to 25% whether or not Canada has an international tax treaty with the country in which the ownership of such corporation resides. It is difficult to understand this proposal if the tax on N.R.O. companies is intended to be the equivalent of withholding tax and such withholding tax is expected to be reduced by treaty to

15%. Such a proposal would tend to eliminate the existence of N.R.O. companies and cause a repatriation of the assets of such companies to the countries in which the foreign ownership resides. We question whether the proposal would be in the interests of Canada in such circumstances.

V. Restriction of the Application of Section 28(1)(d)

The White Paper proposes to eliminate the application of Section 28(1)(d) of the Income Tax Act so far as it applies to dividends received from non-treaty countries. We are conscious of the fact that some countries in which UCC has an interest have no tax treaties with Canada. If Section 28(1)(d) is eliminated, it would seem desirable to reorganize so that dividends would not flow into the Canadian companies which had previously received them tax free. The result would be the loss to the Canadian revenue authorities of withholding tax on such amounts when paid out by way of dividend to the parent company. Some of such foreign countries offer tax holidays for specified periods of time to induce the economic expansion of those countries. In some circumstances, such tax holidays provide exemption of dividends from withholding tax provided the dividends are not taxed in the country of receipt. The effect of the elimination of Section 28(1)(d) in these circumstances would negate the tax advantage in the foreign jurisdiction with consequent reduction of tax

advantage to Canada under the proposal. We assume that the Canadian Government will consider very carefully before eliminating Section 28(1)(d) as proposed.

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